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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1987

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TRANSWESTERN PIPELINE COMPANY,
*Petitioner,*

v.

FEDERAL ENERGY REGULATORY COMMISSION,
*Respondent.*

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## APPENDIX TO THE PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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## APPENDIX A

**TRANSWESTERN PIPELINE COMPANY, Petitioner,**

**v.**

**FEDERAL ENERGY REGULATORY COMMISSION, Respondent.**

**Nos. 85-4597, 86-4550.**

United States Court of Appeals,
Fifth Circuit.

July 7, 1987.

On Petitions for Review of Orders of the Federal Energy Regulatory Commission.

Before CLARK, Chief Judge, THORNBERRY, and HIGGINBOTHAM, Circuit Judges.

CLARK, Chief Judge:

Petitioner Transwestern Pipeline Company (Transwestern) seeks review of Opinion Nos. 238 and 238-A and other related orders of the Federal Energy Regulatory Commission (the Commission). *See Transwestern Pipeline Company,* Opinion No. 238, 32 FERC ¶ 61,009 (1985), *reh. denied,* Opinion 238-A, 36 FERC ¶ 61,175 (1986); *see also Pacific Gas Transmission Company,* 28 FERC ¶ 61,217 (1984), *reh. denied,* 32 FERC ¶ 61,001 (1985), *reh. denied,* 36 FERC ¶ 61,176 (1986).

In generic Order No. 380,[1] the Commission eliminated interstate natural gas pipelines' minimum commodity bills to the extent these provisions permitted the recovery of variable costs. The Commission reasoned that such variable-

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[1] *Elimination of Variable Costs from Certain Natural Gas Pipeline Minimum Commodity Bill Provisions,* Order No. 380, 27 FERC ¶ 61,318; Order No. 380-A, 28 FERC ¶ 61,175; Order No. 380-B, 29 FERC ¶ 61,076; Order No. 380-C, 29 FERC ¶ 61,077; Order No. 380-D, 29 FERC ¶ 61,332 (1984).

cost minimum bills inhibited competition without justification by forcing a pipeline's customers to buy its gas rather than less costly gas from other sources. This order and its rationale were approved by the District of Columbia Circuit in *Wisconsin Gas Co.* v. *Federal Energy Regulatory Commission (FERC),* 770 F.2d 1144 (D.C.Cir.1985), *cert. denied,* ... U.S. ..., 106 S.Ct. 1968, 90 L.Ed.2d 653 (1986).

Questions of the lawfulness of the fixed-cost portion of minimum bills were left to be resolved in individual pipeline proceedings. This is such a proceeding. Transwestern petitions this court to review orders of the Commission which eliminated its fixed-cost minimum bills as applied to its two principal customers and terminated the Commission's investigation into the minimum bill practices of other interstate pipelines supplying California. The Commission's conclusion that Transwestern's fixed-cost minimum bills were unjust and unreasonable because the practice constituted an unreasonable restraint of trade was based on substantial evidence. The remedy imposed was a proper exercise of the Commission's authority under the Natural Gas Act (NGA) and was neither arbitrary nor capricious. It was within the Commission's discretion to terminate its investigation of the other pipelines and determine the lawfulness of Transwestern's fixed-cost minimum bills on the record before it. We affirm.

## I. BACKGROUND

### A. FACTS

Transwestern owns and operates an interstate natural gas pipeline subject to the jurisdiction of the Commission. It provides firm service to two partial requirements customers, Southern California Gas Company (SoCal) and Northwest Central Pipeline Company (Northwest), which account for more than 99.5 percent of Transwestern's gas sales. SoCal is

a local distribution company which sells gas both for resale and for ultimate consumption within the State of California. Transwestern competes for natural gas sales to SoCal with other interstate pipelines and various other sources, including gas sold on the spot market. The largest interstate pipeline serving California and Transwestern's primary competitor there is El Paso Natural Gas Company (El Paso). Northwest is an interstate pipeline which sells primarily to local distribution companies in the Midwest. The majority of its sales are to Kansas Power and Light Company serving the Kansas City, Missouri area.

The Commission first authorized Transwestern to provide service to SoCal's affiliate, Pacific Lighting Gas Supply Company (Pacific),[2] in 1959, when it issued Transwestern a certificate of public convenience and necessity pursuant to § 7 of the NGA, 15 U.S.C. § 717f, to construct an interstate pipeline and sell up to 350 million cubic feet (MMcf) of gas per day. Additional certificates have been issued over the years to Transwestern to expand facilities and sell 750 MMcf per day to SoCal.

The 1959 certificate was conditioned upon Transwestern's filing an initial rate schedule based on the *Seaboard* method[3] of cost classification, cost allocation, and rate design. Under this method, 50 percent of Transwestern's fixed transmission costs and all its "as billed" fixed costs are treated as parts of the demand charge component of the rate and the remaining fixed transmission costs plus all fixed production costs and all its variable costs are classified as parts of the commodity charge. The demand charge is calculated based on the contract demand quantity, which in SoCal's case is 750 MMcf

[2] SoCal and Pacific were both parties in the proceedings before the Commission. Pacific was recently merged into SoCal. We will often refer to them jointly as "SoCal."

[3] See *Atlantic Seaboard Corp,* Opinion No. 225, 11 FPC 43 (1952).

of gas per day. This charge is paid by the customer regardless of how much gas is taken. The commodity charge calculation is based on the number of units of gas sold.

The schedule also included a 91 percent minimum annual commodity bill provision based on the annual contract quantity, which is calculated by multiplying SoCal's contract demand quantity of 750 MMcf per day times 365 days a year. In effect, the minimum bills obligated SoCal to take gas pursuant to the rate schedule or pay Transwestern as if it had taken an average of 682.5 MMcf per day (91 percent of the contract demand quantity) or such lesser amount as Transwestern tendered.[4]

In 1965, the Commission authorized Transwestern to sell 100 MMcf per day to Northwest's predecessor, Cities Services Gas Company. This amount has since been increased to 250 MMcf per day. While the rates in the initial schedules for Northwest were developed using a method different from that used for SoCal, Transwestern's rate design for both principal customers now uses the same method. At the time of Transwestern's rate filing this was the *Seaboard* method. The rates applicable to Northwest also included a 90 percent minimum annual commodity bill.

There is a significant difference, however, between the minimum bills applicable to SoCal and those applicable to Northwest due to a "ratchet" provision in the Northwest agreements. The contract demand quantity which the Northwest contracts specified was to be used in calculating the annual contract quantity did not equal the 250 MMcf

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[4] After Order No. 380 eliminated variable-cost recovery from all interstate pipelines' minimum bills, SoCal was not required to pay the full commodity rate for gas not taken, but only the fixed-cost portion. We explain in more detail below.

per day that Transwestern is authorized to deliver. Transwestern's agreements with Northwest provided that if Transwestern was unable to deliver the daily contract demand quantity, the average daily quantity actually delivered would become the new contract demand quantity in calculating the minimum bill for that year and for every year thereafter. During the 1970's, Transwestern was in severe curtailment and could not deliver 250 MMcf per day to Northwest. Thus, the contract demand quantity used in calculating Northwest's minimum bills was permanently reduced. The ratchet provision in Northwest's minimum bill obligation eventually reduced its take-or-pay requirement to only 59 percent of the 250 MMcf Transwestern is authorized to deliver.

For years neither SoCal nor Northwest had any complaints about the effect of Transwestern's minimum bills. In fact, if the two customers had any complaints it was due to curtailment of natural gas supply rather than any surplus which may have been forced upon them. Then in 1982, both customers had more gas available from Transwestern and other suppliers than they needed to meet demand. This oversupply was in part due to the customers' efforts during the 1970's to develop alternative sources of supply in response to curtailment. Those projects began to produce in the early 1980's. The oversupply was also a consequence of the recession and an increase in gas prices since 1978. In addition, residential consumers conserved gas and switched to electricity, and industrial customers switched to fuel oil, which had become competitive. In short, the natural gas supply was suddenly much greater than the demand; the natural gas surplus, however, was not immediately accompanied by a decrease in gas prices.

## B. COURSE OF PROCEEDINGS

In August 1981 Transwestern filed increased natural gas rates for its customers pursuant to § 4 of the NGA, 15 U.S.C. § 717c. The Commission set the increased rates for hearing, and the parties soon settled most of the disputes concerning the reasonableness of the increased rates. However, they were unable to settle disputes concerning the reasonableness of Transwestern's full-cost minimum bills and its method for cost allocation and rate design. Hearings on these issues were held in June and July of 1983.

Recognizing that the Commission's investigation under § 5 of the NGA, 15 U.S.C. § 717d, of other interstate pipelines supplying California raised similar full-cost minimum bill questions, the Chief Administrative Law Judge (the Chief ALJ) consolidated the Transwestern proceeding with these other cases in December 1983. The Commission affirmed the Chief ALJ's decision.

On May 25, 1984, the Commission issued Order No. 380 eliminating variable costs from the minimum bills of interstate pipelines, including Transwestern. In August 1984, the Commission suspended the consolidated proceeding which included Transwestern's case, in part because Order No. 380 and related rehearings could dispose of many of the issues, and in part because El Paso, Transwestern's major competitor in the southern California market, and its customers reached a settlement setting the fixed-cost minimum bill provision at 60 percent.[5] Transwestern's docket, however,

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[5] *See Pacific Gas Transmission Co.*, 28 FERC ¶ 61,217 (1984) (approving most of El Paso settlement). The Commission eventually terminated the consolidated proceeding because most of the issues had been resolved, including the lawfulness of Transwestern's fixed-cost minimum bills. *See Pacific Gas Transmission Co.*, 32 FERC ¶ 61,001 (1985), and 36 FERC ¶ 61,176 (1986).

was severed for expedited decision since the case had been ready for decision for over a year.

The presiding Administrative Law Judge (the presiding ALJ) issued a decision in the severed Transwestern case in December 1984, reducing Transwestern's fixed-cost minimum bills to 60 percent and rejecting any change in the rate design. On review, the Commission totally eliminated the fixed-cost minimum bills in Opinion No. 238 and denied rehearing in Opinion No. 238-A.[6]

The Commission affirmed the presiding ALJ's finding that the differences between SoCal's and Northwest's minimum bills constituted undue discrimination. This finding was based on the fact that Northwest's minimum bill obligation had ratcheted downward to approximately 59 percent of its actual contract demand quantity while SoCal's remained at the 91 percent level. The ALJ's conclusion that Transwestern's minimum bills should not be eliminated, but rather decreased to 60 percent to remedy the discrimination and place Transwestern's minimum bills at the same level as those of its major California competitor, El Paso, was rejected by the Commission. It found that Transwestern's minimum bills unreasonably restrained trade and thus were unjust and unreasonable. The Commission observed that Transwestern's minimum bills forced Northwest and SoCal to purchase gas from Transwestern even though alternative lower-cost supplies were available, and it found that the minimum bills were not justified. In particular, the Commission concluded that Transwestern's fixed-cost minimum bills allowed it to recover certain fixed costs which should not be guaranteed free from risk—equity return, related taxes, and fixed production costs. The Commission adopted a new

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[6] *Transwestern Pipeline Co.*, Opinion No. 238, 32 FERC ¶61,009 (1985), *reh. denied*, Opinion 238-A, 36 FERC ¶61,175 (1986).

modified fixed variable rate design method which would assure that Transwestern recovered those fixed costs which it was entitled to recover on a risk-free basis. These fixed costs—debt costs and depreciation—would be recovered through the demand charge, which the customer pays based on its contract demand quantity regardless of gas taken.

## II. REVIEW OF THE COMMISSION'S ORDERS

Transwestern petitions this court to review the Commission's orders in Opinion Nos. 238 and 238-A which eliminate Transwestern's minimum bills and the related orders of the Commission which terminate the investigation of other interstate pipelines. The Commission declared Transwestern's fixed-cost minimum bills unlawful and entirely eliminated such bills pursuant to its authority under §§ 4 and 5 of the NGA to regulate rates, charges, and practices of natural gas companies under its jurisdiction.

Section 4(a) provides that rates charged by natural gas companies "shall be just and reasonable, and any such rate or charge that is not just and reasonable is declared to be unlawful." 15 U.S.C. § 717c(a). Section 5(a) provides the basis for the Commission's authority to examine rates to determine whether they comply with the § 4 standard:

> (a) Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order . . . .

In reviewing the substance of the Commission's orders, we are initially guided by § 19(b) of the NGA, which provides that the Commission's factual findings, "if supported by substantial evidence, shall be conclusive." 15 U.S.C. § 717r(b). The Supreme Court has emphasized that "Congress has entrusted the regulation of the natural gas industry to the informed judgment of the Commission, and not to the preferences of reviewing courts. A presumption of validity therefore attaches to each exercise of the Commission's expertise . . . ." *In re Permian Basin Area Rate Cases,* 390 U.S. 747, 767, 88 S.Ct. 1344, 1360, 20 L.Ed.2d 312 (1968). In adherence to the principles articulated in *Permian Basin Area Rate Cases,* this court reviews the Commission's actions on the basis of "(1) whether the Commission abused or exceeded its authority, (2) whether the essential elements chosen by the Commission for its order are supported by substantial evidence, and (3) whether the 'end result' is unjust and unreasonable." *Tenneco Oil Co.* v. *FERC,* 571 F.2d 834, 838 (5th Cir.), *petition for cert. dismissed,* 439 U.S. 801, 99 S.Ct. 43, 58 L.Ed.2d 94 (1978) (citing *Permian Basin Area Rate Cases,* 390 U.S. at 791-92, 88 S.Ct. at 1373); *Cities Service Gas Co.* v. *FERC,* 623 F.2d 1002, 1004–05 (5th Cir.1980).

## A. UNDUE DISCRIMINATION

[1] Transwestern's first challenge to the substance of Opinions No. 238 and No. 238-A focuses on the Commission's discussion of "undue discrimination." Transwestern argues that the Commission's determination that SoCal and Northwest were "similarly situated" customers is not supported by substantial evidence. Transwestern contends that the Commission has misconstrued the relationship between private contracts and regulation under the NGA. Transwestern further asserts that the remedy imposed by the Commission—the total elimination of Transwestern's minimum

bills—was arbitrary and capricious since a finding of unlawful discrimination at most warrants the equalization of the minimum bill levels between customers, not abrogation. Because Transwestern identifies this issue as the Commission's "key finding," we address it preliminary.

At the outset, we would note that the challenged "undue discrimination" finding is not an essential element of the Commission's ultimate determination. The presiding ALJ did not declare Transwestern's minimum bills anti-competitive. Instead, he based his decision on a finding that similarly situated customers were treated differently without justification. The ALJ eliminated that discrimination by reducing Transwestern's minimum bills to a 60 percent level which would equal El Paso's minimum bill level to SoCal. Although the Commission discussed the discrimination issue and generally affirmed the ALJ's finding, it did not rest its decision to eliminate Transwestern's minimum bills on the ALJ's determination. The Commission's central finding is that Transwestern's fixed-cost minimum bills unreasonably restrained trade. This finding makes the ALJ's determination related to discrimination inmaterial. The remedy imposed by the Commission does not stem from any difference between Transwestern's minimal bills to Northwest and its minimum bills to SoCal.

Under § 5 of the NGA, once the Commission found Transwestern's minimum bill practice unlawful, it had the authority to "determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force. . . ." Transwestern's contention that the elimination of its minimum bills was an arbitrary and capricious remedy is thus without merit.

**B.** SUBSTANTIAL EVIDENCE

The Commission's determinations that Transwestern's fixed-cost minimum bills were anti-competitive and should

be entirely eliminated were based on evidence in the record of the past operation of the minimum bills and their effect on competition as well as the probable consequence such provisions would have in the future. The record in this case was closed before Order No. 380 eliminated variable-cost recovery from interstate pipelines' minimum bills. Prior to that elimination, Transwestern's minimum bills forced the customer to take or pay the full commodity rate for any minimum bill volume not taken.

The past operation of these full-cost minimum bills is generally not disputed. It is clear, for example, that the purpose of a full-cost minimum bill is to prevent customers from purchasing less expensive alternative supplies. Transwestern's Senior Vice President testified that the minimum bill was intended to assure that sales will continue to be made when the purchaser has available to it alternative supplies at lower costs. Furthermore, evidence in the record established that Transwestern's full-cost minimum bills prevented SoCal's affiliate Pacific from purchasing lower-cost gas from El Paso in 1982 because of Pacific's commitment to Transwestern to pay the full commodity rate for its minimum bill volume.

Referring to the general situation, the Commission found in Opinion No. 238 that

> both Pacific and Northwest Central had to reduce their purchases from their suppliers. And they had to reduce the price at which they sold their gas. Since Transwestern was a high cost supplier for both, they should have reduced their purchases from Transwestern and increased their purchases from their lower cost suppliers. But they did not because of the necessity of meeting Transwestern's minimum bill obligations. The net effect of Pacific's and Northwest Central's doing so was that consumers paid more for gas than they might otherwise have and competitors were excluded from the markets. (footnotes omitted)

Transwestern does not take issue with this finding of competitive harm. The anti-competitive effect of full-cost minimum bills was decided in Order No. 380 and upheld by the D.C. Circuit in *Wisconsin Gas Co.*, a proceeding in which Transwestern participated.

However, variable costs constituted about 90 percent of the commodity charge in Transwestern's rates. After Order No. 380, Transwestern's minimum bills only required customers to pay about ten percent of the full commodity charge for minimum bill volume not taken. Recognizing that the record was closed before Order No. 380 eliminated variable costs from minimum bill recovery, the Commission based its finding on the anti-competitive impact of Transwestern's fixed-cost minimum bills on a prediction of how those minimum bills would operate in the future in markets served by Transwestern.

The Commission based this prediction on evidence in the record, its knowledge of the industry, and common sense. Specifically, the Commission identified three factors. First, gas supplies available in the southern California and Kansas City markets had exceeded demand for the past few years, and the oversupply was likely to continue. Second, the Commission analogized this situation to the treatment of requirements contracts under antitrust law. Where supply exceeds demand, a requirements contract by its very nature forecloses competition. As an example, the Commission referred to the situation in 1982 when lower-cost supplies were available from El Paso, yet Pacific was forced to purchase its minimum bill volume from Transwestern. Third, the Commission observed that a fixed-cost minimum bill would continue to compel a customer to buy gas from Transwestern rather than from a lower-cost competitor. If the customer bought gas from another supplier, it would still have to pay the supplier for that gas and, in addition, pay Transwestern

for the fixed-cost portion of the minimum bill volume not taken. The customer who purchased alternative supplies would suffer an economic loss unless the cost of such supplies were lower by more than the amount of the fixed-cost minimum bill—in other words, by more than ten percent of Transwestern's commodity charge.

### C. THE COMMISSION'S BALANCE

In its initial response to the Commission's central conclusion that Transwestern's minimum bills unreasonably restrained trade, Transwestern charges that the Commission misunderstands the relationship between contracts and competition. Transwestern claims that the Commission has misapplied antitrust concepts in its effort to demonstrate the unlawfulness of Transwestern's minimum bills. Transwestern refers us to Justice Brandeis' words of caution in *Board of Trade* v. *United States,* 246 U.S. 231, 238, 38 S.Ct. 242, 244, 62 L.Ed. 683 (1918), that "[e]very agreement concerning trade, every regulation of trade, restrains." Transwestern apparently feels that the Commission applied a *per se* rule to strike down any contract which affected competition in natural gas sales.

Had the Commission simply determined that Transwestern's contracts with SoCal and Northwest restrained its customers' options to purchase gas from other suppliers, without more, we would be unable to approve the Commission's reasoning. The Commission did not, however, apply such a *per se* rule to eliminate Transwestern's minimum bill restraints. Instead, it used the very same "rule of reason" analysis articulated by Justice Brandeis in *Board of Trade.* The Commission explained its analysis in Opinion No. 238-A:

> [B]efore we may find a contract term to be an unreasonable restraint of trade we must carefully balance the competitive harm the term causes against the term's

> objectives in light of the alternatives available for achieving those objectives. Only if on balance the term causes more harm than is warranted in light of the term's objectives and the available alternatives, can we find the term to be an unreasonable restraint of trade. It was only after finding that on balance Transwestern's minimum bills caused more harm than was warranted that we concluded that the minimum bills unreasonably restrained trade and hence were unjust and unreasonable. (footnotes omitted)

Transwestern urges that its contracts with its customers constitute a "reasonable" restraint of trade. Transwestern argues that its minimum bills are "considerably less restraining" than exclusive dealing contracts or full-requirements contracts which courts have upheld under the antitrust laws. This invocation of court-made antitrust standards is unpersuasive. The Commission does not enforce or apply the antitrust laws. *Cf. California* v. *Federal Power Commission (FPC),* 369 U.S. 482, 484-90, 82 S.Ct. 901, 903-06, 8 L.Ed.2d 54 (1962).

[2] The Commission's authority to declare a practice unlawful and to prescribe an appropriate remedy stems from §§ 4 and 5 of the NGA. The fact that the Commission may employ a "rule of reason" analysis similar to that developed by courts in antitrust cases does not subject its determination to a court rebalancing of the factors it deemed relevant. When we review the Commission's actions we are not free to apply antitrust standards. Rather, our review examines the Commission's order to assure that it has given reasoned consideration to the relevant evidence and factors before it, not "to supplant the Commission's balance of these interests with one more nearly to [our] liking." *Permian Basin Area Rate Cases,* 390 U.S. at 792, 88 S.Ct. at 1373 (1968).

## D. POSSIBLE JUSTIFICATIONS

The Commission found that the probable consequence of Transwestern's imposition of a minimum bill on its two partial-requirements customers would be to foreclose competition and restrain trade. The Commission then considered whether Transwestern's minimum bills were justified. In *Atlantic Seaboard Corp.*,[7] the Commission identified three "economic factors which usually justify a minimum commodity rate in a pipeline tariff." First, a minimum bill may be justified as a means of protecting the pipeline against the risk of not recovering fixed costs in the commodity component. Second, a minimum bill may be justified as a means of protecting full-requirements customers from bearing a disproportionate share of fixed costs resulting from swings off the system by partial-requirements customers. And third, a minimum bill may be justified as a means of ensuring equitable recovery from customers of a pipeline's take-or-pay costs.

### 1. FIXED-COST RECOVERY

[3] Under the *Seaboard* method of rate design, the commodity charge includes fixed production costs and 50 percent of fixed transmission costs, which include equity return, related taxes, depreciation, and debt cost. The remaining fixed costs are recovered through the demand charge. The Commission found that Transwestern's fixed-cost minimum bills could not be justified on the basis that they recovered fixed costs because the minimum bills recovered costs which did not warrant risk-free recovery. Specifically, the Commission determined that the costs of depreciation and servicing the debt should be guaranteed, but that equity return, related taxes, and fixed production

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[7] *Atlantic Seaboard Corp.*, Opinion No. 553, 38 FPC 91, 95 (1967), *aff'd*, 404 F.2d 1268 (D.C.Cir. 1968) (an opinion separate from the *Seaboard* rate design opinion, *supra* note. 3).

costs should be subject to risk.[8] Since Transwestern's minimum bills guaranteed recovery of all fixed costs, they could not be justified on this basis.

To permit fixed-cost recovery which is warranted, the Commission adopted the modified fixed variable rate design. Under this method, all fixed costs are assessed as parts of the demand charge, except equity return, related taxes, and fixed production costs. Thus, all fixed costs which Transwestern should recover will be recovered through the demand charge without the imposition of a minimum bill.

Transwestern responds that the Commission cannot prescribe a new mechanism for the recovery of fixed costs merely because it prefers it. Transwestern asserts that the Commission must first find the existing provision unlawful under § 5 of the NGA. The Commission, however, did not eliminate Transwestern's minimum bills because it preferred the modified fixed variable rate design to the *Seaboard* method. It first found the minimum bills unlawful because they unreasonably restrained trade. It further found that Transwestern's minimum bills were not justified on the ground that they permitted recovery of fixed costs that should not be guaranteed, not because a new method of rate design would better accomplish the purpose.

Transwestern next contends that there was no record evidence that the modified fixed variable rate design would assure the recovery of fixed costs assigned to the commodity component. Transwestern claims there was no evidence that its sales levels without minimum bills would remain sufficient to recover those fixed costs the Commission left at risk. This begs the issue. The point of the Commission's determination was to subject certain fixed costs to market risks. The Commission placed equity return at risk, because it did not

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[8] *See Texas Eastern Transmission Corp.*, 30 FERC ¶ 61,144, *reh. granted in part and denied in part*, 32 FERC ¶ 61,056 (1985).

think Transwestern should be guaranteed any profit. Rather, Transwestern will earn profits only when it makes sales. Similarly, the Commission's conclusion that fixed production costs should be fully at risk is based on a determination that Transwestern should have the incentive to minimize costs; such an incentive will motivate Transwestern to make prudent gathering and production expenditures.[9]

Transwestern does not really dispute the underlying determination of cost allocation, but maintains that it should be "guaranteed a reasonable opportunity to earn a return on its investment." The Commission's decision here does not deny Transwestern such a reasonable opportunity. The Commission has only refused to protect Transwestern's profit from competition and provided Transwestern what the Commission determined to be the appropriate incentive to run its business efficiently. "[R]egulation does not insure that the business shall produce net revenues." *FPC* v. *Natural Gas*

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[9] The Commission discussed this allocation and classification of fixed costs at greater length in the *Texas Eastern Transmission Corp.* order, *see supra* note 9. The Commission reasoned:

> In the unregulated competitive world, profits are earned and maximized only if the business manages its operations efficiently and is capable of reading and acting upon price signals to determine the appropriate level of customer demand. As we move to increasing competition in the gas pipeline industry, there is no economic reason to assure pipeline profits where sales are not made. If equity return and associated taxes are included in the commodity component to be recovered over annual throughput, Texas Eastern will earn profits only when it makes sales and transports gas and will maximize its earnings by meeting and exceeding its volume projections. This classification of profits holds the pipeline responsible for its management decisions and provides necessary incentive to Texas Eastern to purchase gas both at the quantity and at the price demanded by its customers. We will therefore adopt a modified fixed variable methodology . . . in which the full equity return and associated taxes are at risk in the commodity charge of Texas Eastern's rates.

30 FERC ¶61,144 at 61,283 (footnote omitted).

*Pipeline Co.*, 315 U.S. 575, 590, 62 S.Ct. 736, 745, 86 L.Ed. 1037 (1942).

2. PROTECTION OF FULL-REQUIREMENTS CUSTOMERS

[4] Minimum bills may also be justified on the ground that they protect full-requirements customers from bearing a disproportionate share of fixed costs should partial-requirements customers reduce purchases in favor of alternative supplies. Presumably, a substantial swing off the system by one customer could result in higher rates for all customers, since more fixed costs would have to be recovered per unit of gas sold.

Transwestern does not argue on appeal that its minimum bills can be justified on the basis of protecting full-requirements customers. Furthermore, Transwestern did not seek to justify its bills before the Commission on this basis. The Commission chose to consider this justification out of fairness to Transwestern's full-requirements customers, even though such full-requirements customers account for less than one-half percent of Transwestern's gas sales and did not intervene before the Commission. We too address the justification to determine that the end result is not unjust.

The Commission rejected this possible justification based on evidence that actual rate increases were "modest," that any impact on Transwestern's full-requirements customers would be short-term, and that Transwestern has taken numerous steps to reduce its gas costs so that it can compete for sales to its partial-requirements customers. Such cost reduction will benefit full-requirements customers whose rates also reflect gas costs. It is also significant that Transwestern's partial-requirements customers account for 99.5 percent of Transwestern's total gas sales. Since Transwestern will certainly want to maintain sales to these customers, it stands to reason that it will seek to make its gas even more

competitive. If it does so, its full-requirements customers will benefit in the long run. In any event, Transwestern's minimum bills cannot be justified on the basis that they are needed to protect full-requirements customers.

### 3. TAKE-OR-PAY OBLIGATIONS

[5] Transwestern's third possible justification is the most superficially appealing. It concerns the recovery of take-or-pay obligations governing wellhead sales between it and its producers. Under a take-or-pay contract, a pipeline must take or pay for a minimum amount of gas. If partial-requirements customers purchase gas from another supplier, the pipeline may be unable to sell as much gas as it is obligated to purchase. The pipeline will then have to pay producers for gas it does not take. Take-or-pay liabilities, if prudently incurred, become a fixed cost on the system and can be passed on to customers in the form of increased rates. A minimum bill can be justified as a means of ensuring equitable recovery of take-or-pay costs from all customers. In Order No. 380, the Commission recognized that this justification is another way of assuring protection of full-requirements customers from the actions of partial-requirements customers. The Commission has always given such take-or-pay questions "special consideration," as it has done here.

The Commission recognized that a minimum bill may be permissible if used to ensure that carrying costs associated with take-or-pay liabilities will be borne by the customers that caused the liabilities to be incurred. The Commission, however, found no connection between the minimum bill payments the customers made under Transwestern's rate schedules and the carrying costs associated with take-or-pay liabilities that Transwestern could legitimately recover from its partial-requirements customers. Accordingly, the Commission found that Transwestern's minimum bills were not justified on the ground that they ensured equitable recovery

from Transwestern's customers of costs associated with take-or-pay liabilities.

Transwestern does not really argue that its minimum bills are necessary to ensure equitable recovery of take-or-pay costs from all customers. Rather, Transwestern asserts that it has enormous take-or-pay obligations and that its minimum bills, even though "not precisely calibrated" to the level of its take-or-pay liability, still serve the purpose of recovering the cost of take-or-pay payments.

Transwestern acknowledges that the Commission has instituted alternative approaches to an industry-wide take-or-pay crisis, but asserts that the Commission is avoiding its responsibility to deal adequately with the dilemma. Transwestern claims that the Commission in Order No. 380 used the same "alternative approaches" argument to postpone its duty to find an adequate solution. In *Wisconsin Gas Co.*, 770 F.2d at 1159-60, the D.C. Circuit deferred to the Commission's discretion to deal with take-or-pay issues in separate proceedings.

The take-or-pay issue posed here is a separate matter which is being addressed in other proceedings before the Commission and through other means. Indeed, Transwestern currently has a proposal before the Commission to allocate costs of settling take-or-pay liability directly to the customers who caused such costs to be incurred. The Commission is not ignoring the issue. None of Transwestern's contentions invoke any proper take-or-pay justification.

The take-or-pay question is, moreover, a hypothetical issue on the record in this case. No evidence advanced indicates that Transwestern has actually made any payments to producers under its take-or-pay contracts. The Commission's decision to confront the potential take-or-pay problem through alternative approaches and in other cases has not been shown to be unreasonable, arbitrary, or capricious.

### 4. OTHER JUSTIFICATIONS

[6] The presiding ALJ considered an additional justification for Transwestern's imposition of a minimum bill. El Paso had settled on, and the Commission had approved, a 60 percent minimum bill for SoCal. Accordingly, the ALJ set Transwestern's minimum bill level at 60 percent, the same level as its major competitor. The basis of this determination was that Transwestern should not be placed in economic jeopardy.

The Commission found that setting the pipeline's minimum bill on the basis of other pipelines' minimum bills ignores the consumers. If a 60 percent minimum bill is anticompetitive it cannot be justified on the basis that it meets one other competitor. If that were not so El Paso could justify its SoCal minimum bills on the basis of Transwestern's at its next rate hearing. This ping-pong effect could mean that consumers would never be free of the unwarranted cost. We are similarly convinced that there is no basis for this justification. Finally, the record shows that as part of an approved settlement, El Paso's minimum bills will be placed at the same level as Transwestern's, which means they both will be eliminated.

## E. SUFFICIENCY OF THE RECORD

[7] Transwestern's principle attack on the substance of the Commission's determination actually centers on what it considers to be a deficient record due to the modification of its minimum bills to exclude variable-cost recovery after Order No. 380. Since the record was created on the assumption that the lawfulness of full-cost minimum bills were at issue, Transwestern claims that there was no evidence before the Commission with respect to the competitive impact of fixed-cost minimum bills.

In its opinions, the Commission acknowledged that the variable-cost portion of Transwestern's minimum bills had been eliminated pursuant to Order No. 380. The Commission, however, was not without record evidence to rule on the lawfulness of the fixed-cost portion of Transwestern's minimum bills. Fixed costs are part of full-cost minimum bills. The question whether full-cost minimum bills should be entirely eliminated necessarily encompasses the question whether the fixed-cost portion should be eliminated also. The issues were squarely presented in the hearings before the record was closed. Kansas Power and Light Company, an intervenor before this court and a party before the Commission, supported only the elimination of variable costs, while the Commission staff and the Governor of California (also parties to the proceedings) argued for the elimination of both variable and fixed costs.

Transwestern had a full, fair opportunity to present evidence on the lawfulness of its fixed cost minimum bills. The Commission was not obligated to postpone a decision on the lawfulness of Transwestern's minimum bills until the record was supplemented with evidence of Transwestern's actual experience with only fixed-cost recovery. The Commission fulfilled its responsibility to make "a conscientious effort to take into account what is known as to past experience and what is reasonably predictable about the future." *Wisconsin Gas,* 770 F.2d at 1158 (quoting *American Public Gas Association* v. *FPC,* 567 F.2d 1016, 1037 (D.C. Cir. 1977), *cert. denied,* 435 U.S. 907, 98 S.Ct. 1456, 55 L.Ed.2d 499 (1978)). The evidence was sufficient to support the Commission's finding that even fixed-cost minimum bills could coerce SoCal and Northwest into purchasing higher-cost gas from Transwestern instead of alternative, lower-cost supplies.

## F. THE TERMINATION OF THE INVESTIGATION OF THE OTHER PIPELINES

[8] Another issue raised by Transwestern which is related to the sufficiency of the record upon which the Commission rendered its decision involves the Commission's investigation of the other interstate pipelines supplying California.[10] Transwestern contends that the Commission's competitive impact findings were lacking in support because evidence of Transwestern's competitors' minimum bills was not before the Commission. Transwestern submits that the Chief ALJ consolidated the Transwestern proceeding with the investigation of these other pipelines and with the El Paso proceeding so that the question of the lawfulness of Transwestern's minimum bills would not be decided in a vacuum. Transwestern charges that the Commission, which initially affirmed the Chief ALJ's consolidation decision, discontinued its investigation without adequate explanation why it was reversing the Chief ALJ's findings. Transwestern argues that this action along with the Commission's refusal to reopen the record after the entry of Order No. 380 was arbitrary, an abuse of discretion, and a denial of due process.

In Opinion No. 238-A, the Commission correctly rejected these additional claims that the record was deficient. The possible competitive effect of the other pipelines' minimum bills cannot alter the determination that Transwestern's minimum bills had an adverse cost effect on its customers. This finding is supported by substantial evidence in the record. Just as was the case with regard to El Paso, Transwestern's minimum bills cannot be justified by the existence of other pipelines' minimum bills.

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[10] These other pipelines are distributor-affiliated pipelines; they include Pacific Gas Transmission Co.; Pacific Interstate Transmission Co.; Pacific Offshore Production Co.; and Pacific Interstate Offshore Co.

[9] Furthermore, the Commission possesses broad discretion to organize its case-load and to determine which issues are to be decided. *Fort Pierce Utility Authority* v. *FPC,* 526 F.2d 993, 999 (5th Cir.1976); *Louisiana Power & Light Co.* v. *FPC,* 526 F.2d 898, 910 (5th Cir.1976). The Commission severed the Transwestern proceeding and terminated its investigation because it determined that Order No. 380, related rehearings, and other events had mooted most of the issues in the consolidated proceeding. The Commission determined that it was more efficient to deal with the issue of the lawfulness of fixed-cost minimum bills on an individual basis. This action was neither arbitrary nor an abuse of the Commission's administrative discretion.

Transwestern also claims that the Commission's actions denied it due process but offers no legal basis for this assertion, and we can find none. To the contrary, the record demonstrates that Transwestern had a full, fair opportunity to address and submit evidence on the lawfulness of its fixed-cost minimum bills.

G. BURDEN OF PROOF

In Opinion No. 238, the Commission erroneously held that Transwestern bore the burden of proving that its minimum bills were lawful. In Opinion No. 238-A, the Commission corrected this holding in reliance on *ANR Pipeline Co.* v. *FERC,* 771 F.2d 507, 514 (D.C.Cir.1985), and placed the burden of proof on the parties supporting a change in Transwestern's minimum bills. Transwestern contends that the Commission has attempted to obscure the burden of proof issue and that, despite its formal correction, it really did place the burden on Transwestern to justify its minimum bills.

[10] The Commission required that the parties challenging Transwestern's minimum bills demonstrate that the fixed-cost minimum bills restrained trade. Transwestern

submits that this is no burden at all because every contract restrains trade. But, as we discussed in a previous section, the Commission did not simply determine that Transwestern's minimum bills constituted a restraint; rather, the Commission found the minimum bills were shown to be anti-competitive based on evidence in the record concerning their purpose, past experience with Transwestern's full-cost minimum bills, and the probable consequence that fixed-cost minimum bills would have in the future. This evidence satisfied the challenging parties' burden of showing that the inclusion of minimum bills in Transwestern's rate schedules would cause competitive harm. The Commission then looked to see whether Transwestern had demonstrated justifications for the minimum bills. The burden placed on Transwestern was not a burden of persuasion. Transwestern was not required to prove by a preponderance of the evidence that its minimum bills were justified. Rather, it was a burden of production under which Transwestern was obligated merely to proffer justifications for its minimum bills. The ultimate burden of proving competitive harm remained on the parties challenging Transwestern's minimum bills and seeking their elimination.

Before the Commission, Transwestern did not attempt to justify its minimum bills on the ground that they protected full-requirements customers from cost-shifting due to fixed costs prudently incurred or even costs associated with take-or-pay payments. Yet, the Commission thoroughly considered each of those justifications, as well as Transwestern's assertions that it should recover all its fixed-costs through the guaranteed mechanism of a minimum bill. The Commission found that Transwestern's minimum bills were not justified, in light of the competitive harm. There was no impermissible shift of the burden of proof to Transwestern.

## H. STATUTORY AUTHORITY

[11, 12] Transwestern challenges the Commission's statutory authority to impose the remedy of total elimination of minimum bills on the basis that abrogation of its minimum bills constitutes an unlawful revocation or modification of its certificate of public convenience and necessity issued under § 7 of the NGA. The D.C. Circuit rejected this argument in *Wisconsin Gas Co.*, 770 F.2d at 1153 n. 9, and we reject it here. Section 7 does not guarantee that the original conditions upon which the certificate was authorized will never change. *See Atlantic Refining Co.* v. *Public Services Commission,* 360 U.S. 378, 389, 79 S.Ct. 1246, 1253, 3 L.Ed.2d 1312 (1959). Section 5 of the NGA expressly empowers the Commission to change rates or practices, such as the fixed-cost minimum bills at issue here, if such provisions become unjust and unreasonable. While elimination of the minimum bills alters rates, it does not affect Transwestern's authorized service under its certificate.

## III. SUMMARY

We uphold the Commission's orders which eliminated Transwestern's minimum bills and which terminated the Commission's investigation into the minimum bill practices of the other interstate pipelines supplying California. The Commission's conclusion that Transwestern's minimum bills unreasonably restrained trade was based on substantial evidence. It was not necessary for the Commission to delay its decision in order to permit supplementation of the record with evidence of the effects of operations after the modification of Transwestern's fixed-cost minimum bills by Order No. 380. The Commission did not abuse its discretion by terminating the other investigations. The Commission's decision to eliminate Transwestern's minimum bills in their entirety was neither arbitrary nor capricious, but was a

proper exercise of the Commission's authority to regulate rates and practices of interstate pipelines under the Natural Gas Act.

The Commission's opinions in Nos. 238 and 238-A and its related orders which terminated the investigation of other interstate pipelines are

AFFIRMED.

# APPENDIX B
# UNITED STATES COURT OF APPEALS
# FOR THE FIFTH CIRCUIT

Nos. 85-4597 and 86-4550

TRANSWESTERN PIPELINE COMPANY,

*Petitioner,*

versus

FEDERAL ENERGY REGULATORY COMMISSION,

*Respondent.*

ON PETITIONS FOR REVIEW OF ORDERS OF THE FEDERAL ENERGY REGULATORY COMMISSION

Before CLARK, Chief Judge, THORNBERRY, and HIGGINBOTHAM, Circuit Judges.

J U D G M E N T

This cause came on to be heard on the petitions of the Transwestern Pipeline Company for review of orders of the Federal Energy Regulatory Commission, and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the petitions for review of orders of the Federal Energy Regulatory Commission in this cause are granted, and the orders of the Federal Energy Regulatory Commission are affirmed.

July 7, 1987

ISSUED AS MANDATE: July 29, 1987

# APPENDIX C

## UNITED STATES OF AMERICA
## FEDERAL ENERGY REGULATORY COMMISSION

PIPELINE RATES: MINIMUM BILLS
RATE DESIGN

Before Commissioners: Raymond J. O'Connor, Chairman;
Georgiana Sheldon, A. G. Sousa and Charles G. Stalon.

Transwestern Pipeline Company

Docket Nos. RP81-130-007,
RP81-130-017,
RP81-130-018,
RP81-130-019,
RP81-130-020,
RP81-130-022,
and RP83-25-000

## OPINION NO. 238

## OPINION AND ORDER ELIMINATING MINIMUM COMMODITY BILLS AND ESTABLISHING A JUST AND REASONABLE RATE DESIGN

**(Issued July 1, 1985)**

### I. INTRODUCTION

Before us for review are exceptions to an administrative law judge's initial decision.[1] The principal issues raised by these exceptions are:

(1) Should the minimum commodity bills in Transwestern Pipeline Company's (Transwestern) rate schedule be modified or eliminated?

(2) If the minimum commodity bills are modified or eliminated, should the method Transwestern uses to

[1] *Transwestern Pipeline Co.*, 29 FERC ¶ 63,054 (1984).

classify and allocate costs and design its rates be modified?

Based on our review of the record we hold that the minimum bills should be eliminated. We also hold that the method Transwestern uses to classify and allocate costs and design its rates should be changed and find that Transwestern should use the modified fixed-variable method advocated by the Commission staff.

## II. PROCEDURAL HISTORY

The procedural history of this case is tortured. But the essentials of the story can be rather simply told. The case began on August 28, 1981, when Transwestern filed, pursuant to section 4 of the Natural Gas Act, increased rates for its customers. The Commission suspended the effectiveness of the increased rates for five months, the maximum suspension permitted by the Act, allowed the increased rates to become effective subject to refund on February 28, 1982, and directed that a hearing be held concerning the reasonableness of the increased rates.[2] The increased rates remained in effect until June 1, 1983, when they were superseded by the increased rates Transwestern filed in Docket No. RP83-25.

After numerous discussions the parties settled most of the disputes concerning the reasonableness of the increased rates. The parties, however, were unable to settle disputes concerning, among other things, the reasonableness of Transwestern's minimum commodity bills and its method for classifying and allocating costs and designing rates. The parties accordingly agreed that these disputes would be reserved for hearing and Commission decision. Specifically, the parties agreed that "the outcome of the reserved issues

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[2] *Transwestern Pipeline Co.*, 16 FERC ¶61,240 (1981).

shall be prospective from the date on which a Commission order determining such issues becomes final."[3]

This settlement was filed with the Commission on February 25, 1983, and approved by the Commission on May 2, 1983.[4] Hearings on the reserved issues were held in June and July of 1983. The law judge issued an initial decision on some of the reserved issues, which are not here material, on January 10, 1984.[5] The law judge issued his initial decision concerning the issues now before us on December 11, 1984.

## III. THE FACTS

Transwestern provides firm service to two partial requirements customers, Pacific Lighting Gas Supply Company (Pacific) and Northwest Central Gas Company (Northwest Central).[6] The Commission first authorized Transwestern to provide service to Pacific in 1959 when it issued a certificate of public convenience and necessity to Transwestern to construct a pipeline from the Permian Basin and the Texas-Oklahoma Panhandle area to Needles, California, and sell up to 350,000 Mcf per day to Pacific.[7] Pacific, in turn, was to deliver Transwestern's gas, along with gas it purchased from El Paso Natural Gas Company (El Paso) and other suppliers, to its affiliates — now consolidated into one company, Southern California Gas Company (SoCal) — which would

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[3] Exh. 106, p. 14 (Art. V).

[4] *Transwestern Pipeline Co.*, 23 FERC ¶ 61,209 (1983).

[5] *Transwestern Pipeline Co.*, 26 FERC ¶ 63,008. *aff'd*, 27 FERC ¶ 61,255 (1984).

[6] Pacific and Northwest Central are, for all practical purposes, Transwestern's only customers. Historically, their purchases have accounted for about 99 percent of Transwestern's sales. Exh. 85, p.4.

[7] *Transwestern Pipeline Co.*, Opinion No, 328, 22 FPC 391, *modified*, Opinion No. 328-A, 22 FPC 542 (1959).

resell the gas at retail and wholesale throughout the southern California market.[8] Over the years the Commission has issued additional certificates to Transwestern to expand facilities and to sell 750,000 Mcf per day to Pacific.[9]

The Commission authorized Transwestern to provide service to Northwest Central in 1965 when it issued a certificate to Transwestern to construct certain facilities and to sell 100,000 Mcf per day to Cities Services Gas Company, which is now Northwest Central.[10] Northwest Central was, in turn, to deliver the gas, along with gas it purchased from other suppliers, in its market area of eastern Kansas and western Missouri but principally to the Gas Service Company (GSC), which distributes gas in the Kansas City metropolitan area. In 1967 the Commission issued Transwestern another certificate that authorized Transwestern to sell an additional 150,000 Mcf per day to Northwest Central.[11]

In issuing the 1959 certificate for service to Pacific and the two certificates for service to Northwest Central, the Commission granted the request of Transwestern and its customers to condition each certificate on Transwestern's filing an initial rate schedule. The rates in the initial schedule for service to Pacific, now known as CDQ-1, were developed using the *Seabord* method[12] of cost classification, cost allocation, and rate design.[13] Under this method 50 percent of

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[8] Historically, SoCal has served about 99 percent of the total gas needs of the southern California market. Exh. 48, p. 2.

[9] *Transwestern Pipeline Co.*, Opinion No. 500, 36 FPC 176, *modified*, Opinion No. 500-A, 36 FPC 1010 (1966); *Transwestern Pipeline Co.*, 41 FPC 134 (1969).

[10] *Transwestern Pipeline Co.*, Opinion No. 472, 34 FPC 659 (1965).

[11] *Transwestern Pipeline Co.*, Opinion No. 472, 34 FPC 659 (1965).

[12] *Atlantic Seaboard Corp.*, Opinion No. 225, 11 FPC 43 (1952).

[13] *Transwestern Pipeline Co.*, 22 FPC at 394.

Transwestern's fixed transmission costs and all its "as-billed" fixed costs are classified to the demand component while its remaining fixed transmission costs plus all its fixed production costs and all its variable costs are classified to the commodity component. A demand rate is then developed to recover the costs included in the demand component, and a commodity rate is developed to recover the costs included in the commodity component. The schedule also included a 91 percent minimum annual commodity bill provision[14] and, in effect, because Pacific had agreed to take no less than 75 percent of its daily contract demand, a monthly minimum bill.[15]

The rates in the initial schedules for Northwest Central, now known as CDQ-2 and CDQ-3,[16] were developed using a method upon which Transwestern and Northwest Central had agreed.[17] Both schedules also included 90 percent minimum annual commodity bills.

Over the years, there have been some changes in the three rate schedules since Transwestern first filed them in compliance with its certificates. But only two are of note. First, Transwestern now uses the same method to develop Northwest Central's rates as it does to develop Pacific's rates. That method has generally been the *Seabord* method.[18]

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[14] *Transwestern Pipeline Co.*, 22 FPC at 394, 543.

[15] *Id.* at 410.

[16] Rate Schedule CDQ-2 governs deliveries to Northwest Central in Oklahoma; Rate Schedule CDQ-3 governs deliveries in Texas.

[17] *Transwestern Pipeline Co.*, 34 FPC at 663, 680.

[18] For a brief period in the late 1970's and early 1980's Transwestern developed its rates using the *United* method. It did so in Docket Nos. RP77-19, RP78-88, and in this case. Under the *United* method 25 percent of the fixed transmission costs are classified to the demand component and 75 percent to the commodity component. *See* United Gas Pipeline Co., Opinion No. 671, 50 FPC 1348 (1972).

Secondly, the monthly minimum bill for Pacific was modified because Pacific had agreed to an 80 percent minimum daily take obligation.[19]

Thus, for a number of years the customers' payments have been determined in the following way: In each month Pacific and Northwest Central pay both a demand charge and a commodity charge. The demand charge is determined by multiplying the demand rate by each customer's contract demand by the days in the month. The contract demand equals the amount of gas Transwestern is obligated by its certificates to deliver each day to its customers. In the case of Pacific this amount is 750,000 Mcf, and in the case of Northwest Central it is 250,000 Mcf. The commodity charge is determined by multiplying the commodity rate by the amount of gas each customer takes in the month. Because it is obligated to take each day 80 percent of its contract demand, Pacific's monthly commodity charge is based on a take of at least 600,000 Mcf per day.[20]

In addition to these basic charges, each customer may pay minimum annual bill charges to Transwestern. There are, however, significant differences between the charges the two customers may pay. The minimum annual bill in the rate schedule for Pacific provides that in each year Pacific will pay at a minimum the demand charge for each month plus an amount equal to 91 percent of the annual contract quantity (ACQ) multiplied by the commodity rate. The ACQ is

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In its most recent rate case, Docket No. RP83-25, Transwestern has returned to the *Seabord* method. *See* Transwestern Pipeline Co., Docket No. 83-25 (July 1, 1983) (letter order). Since our order in this proceeding will be prospective, the currently effective *Seabord* method is, as the law judge correctly noted, 29 FERC at 65,154, the relevant methodology to be considered in this case.

[19] *See* Exh. 22.

[20] (.80 × 750,000 Mcf = 600,000 Mcf).

simply the daily contract demand quantity of 750,000 Mcf multiplied by the days in the years, or 273,750,000 Mcf. If Transwestern is unable to deliver at least 91 percent of this amount, Pacific must pay an amount equal to the amount Transwestern actually delivers. Thus, over the course of the year Pacific must take or pay as if it had taken an average of 682,500 Mcf per day or such lesser amount as Transwestern tenders.

The minimum annual bill applicable to Northwest Central provides that in each year Northwest Central will pay the demand charge for each month plus an amount equal to 90 percent of the contract demand quantities specified in the service agreements multiplied by the number of days in the year multiplied by the commodity rate. This is only slightly different from the minimum annual bill applicable to Pacific, which requires it to take or pay for 91 percent of its annual contract quantity. A more significant difference, however, is that the contract demand quantities the service agreements specify to be used in calculating the minimum commodity bills do not equal the 250,000 Mcf Transwestern is obligated to deliver. Both service agreements provide that, if over the course of a year Transwestern is unable for various reasons to deliver on average the daily contract demand quantity, the average daily quantity Transwestern was able to deliver shall be the new contract demand quantity used in calculating the minimum bill for that year and every year thereafter. During the 1970's Transwestern was in severe curtailment and hence was unable to deliver anywhere near 250,000 Mcf per day to Northwest Central.[21] Thus, the contract demand used in calculating Northwest Central's minimum bills is now significantly less than 250,000 Mcf per day. According to Transwestern and

[21] In 1978 Transwestern's curtailment was 39.6 percent of its total certificate obligations. Exh. 1, p. 5.

Northwest Central, the minimum annual bills require Northwest Central to take or pay as if it had taken only about 59 percent of the 250,000 Mcf Transwestern is obligated to deliver.[22]

## IV. TRANSWESTERN'S MINIMUM BILLS ARE UNLAWFUL

For a number of years the customers had few complaints about the operation of Transwestern's rate schedules. This changed in 1982. In that year both Pacific and Northwest Central had more gas available from Transwestern and their other suppliers than they needed to meet demand.[23] There

[22] During the hearing there was a dispute concerning the interpretation of the two service agreements. The staff's witness concluded that, because of a difference in the wording of the two agreements, Northwest Central's minimum bill obligation was considerably higher than 59 percent. Exh. 85, p. 35.

The difference of opinion between the staff, on the one hand, and Transwestern and Northwest Central, on the other, was resolved after the hearing when, in his first initial decision, 26 FERC at 65,0171-18, the judge ordered Transwestern to file a contract between it and Northwest Central. Exh. 92. This contract provides that the service agreements will be interpreted as providing that the amounts Transwestern delivered to Northwest Central in 1978 are the contract demands to be used in calculating the minimum bills. *See also* Exh. 67, p. 4 and the judge's initial decision in this part of the case, 29 FERC at 65,154. Since this contract is now on file, it is controlling.

[23] For Pacific it is quite clearly established that 1982 represented a change in the relationship of its supply to its demand. *See* Exh. 55, p. 16; Exh. 60; Exh. 82, p. 3. According to SoCal's operating records for 1982, surplus supplies available to it directly or indirectly through Pacific exceeded sales by about 400 MMcf per day an average for the whole year. Exh. 82, p. 4; Exh. 83.

The supply surplus for Northwest Central may have begun before 1982. The record is not sufficiently well-developed concerning Northwest Central's situation to permit us to be precise. But it is clear that in 1982 Northwest Central's supplies exceeded its demand. In that year Northwest Central met its total demand while only purchasing about 55 percent of the gas available to it from Transwestern. Exh. 67, p. 4.

were a number of reasons for that. In part it was an after-effect of Transwestern's curtailment in the 1970's. In response to being curtailed, both customers developed other sources of supply.[24] Those projects began to produce in the early 1980's.[25] In part the oversupply was also a consequence of the recession.[26] And in part it was also a consequence of the increase in gas prices since 1978. Residential customers conserved gas and switched to electricity,[27] while industrial customers switched to fuel oil, which had become competitive.[28]

Thus, both Pacific and Northwest Central had to reduce their purchases from their suppliers. And they had to reduce the price at which they sold their gas. Since Transwestern was a high cost supplier for both, they should have reduced

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[24] For Pacific, see Exh. 51, p. 4; for Northwest Central, see Exh. 69, p. 6; Tr. 3173.

[25] For Pacific, see Exh. 51, pp. 4-5. For Northwest Central, see Tr. 3167.

[26] Tr. 3193.

[27] The record shows that SoCal's residential customers' average annual usage per meter declined from 101 Mcf in 1973 to 77 Mcf in 1982. Exh. 48, p. 6. The record does not provide comparable information for residential customers that buy gas from Northwest Central's customers, such as GSG. But we assume that consumers in Kansas and Missouri are no different from consumers in southern California.

[28] Exh. 48, p. 4; Exh. 67, p. 6; Tr. 3196.

SoCal has six utility electric generating (UEG) customers. Each has the ability to switch from gas to fuel oil. SoCal's second largest UEG customer, the Los Angeles Department of Water and Power, took relatively little gas after May, 1982, when it switched from gas to oil for most of its "non-episodic days" operation. Tr. 2606. Because of the loss of this load SoCal's total sales in 1982 were reduced by 25-30 Bcf. *Id.* And in January and February, 1983, SoCal's largest UEG customer, Southern California Edison Company, switched from gas to oil. Exh. 48, p. 4. This switch alone reduced SoCal's sales by 12 Bcf. Tr. 2576. Northwest Central's experience was similar. *See* Exh. 67, p. 6.

their purchases from Transwestern and increased their purchases from their lower cost suppliers.[29] But they did not[30] because of the necessity of meeting Transwestern's minimum bill obligations.[31] The net effect of Pacific's and Northwest Central's doing so was that consumers paid more for gas than they might otherwise have[32] and competitors were excluded from the markets.[33]

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[29] Of the six suppliers available to Pacific and SoCal, Transwestern had the second highest price. Exh. 55, p. 14. And of the five sources of supply available to Northwest Central, Transwestern also had the second highest price. *See* Tr. 3166-69, 3217-18.

[30] For example, in the fourth quarter of 1982, Pacific and SoCal purchased on average 657 MMcf per day from Transwestern and 1,270 MMcf per day from El Paso although El Paso could have supplied far more gas and at a lower price. Exh. 38, p. 8.

Northwest Central also had available to it gas at a price lower than Transwestern's. Tr. 3169.

[31] *See* Exh. 38, p. 8.

[32] According to one estimate, in 1982 consumers in southern California paid about $49 million in increased gas costs as a result of Transwestern's minimum bill. Exh. 82, p. 6; Exh. 84.

The record does not provide a similar estimate for Northwest Central. But the same appears to be true for the consumers in Kansas and Missouri it serves. In 1982 Transwestern supplied about 16 percent of Northwest Central's gas. But Transwestern's gas constituted about 21 percent of Northwest Central's gas costs. Exh. 67, p. 4.

[33] For example, in November, 1982, when Pacific and SoCal were buying gas from Transwestern to meet its minimum bill requirements, SoCal sold 78,765 MMcf. Of this total SoCal purchased 43.4 percent, or 34,323 MMcf, from El Paso and 27.3 percent, or 21,561 MMcf, from Transwestern. Exh. 83. Yet El Paso could have supplied 66.7 percent, or 52,573 MMcf. *Id.* Thus, since the price of El Paso's gas was lower than Transwestern's, Transwestern's minimum bill foreclosed El Paso from about 23.3 percent of the southern California gas market. And for the eight months in 1982 after the southern California market changed to a demand constrained market, Transwestern's minimum bill foreclosed El Paso from about 15.2 percent of the market. *Id.*

Since it is likely that for some years in the future both Pacific and Northwest Central will continue to have available more gas than they need to meet demand, both had reason to complain about Transwestern's minimum bills.[34] And they did, along with some of their customers, suppliers, affected state commissions, and our staff. At the hearing and in their briefs to the judge they all argued that Transwestern's minimum bill and minimum take provisions were unlawful. This is so, they said, because the minimum bill and minimum take provisions:

(1) Restrain trade by forcing Pacific and Northwest Central to buy gas from Transwestern when they could buy gas at a lower price from other suppliers.

(2) Require Pacific and Northwest Central to pay Transwestern for costs it does not incur in providing service to them. This is necessarily so because Transwestern's minimum bills take effect only when its customers do not buy gas. In such situations Transwestern incurs no variable costs. Yet the commodity rate used in calculating the minimum bills recovers variable costs.

(3) Unduly discriminate against Pacific and unduly favor Northwest Central.[35]

Transwestern of course took the opposite position.

In his initial decision, the law judge did not address the intervenors' and the staff's first two arguments. Though not expressly stated, the reason the judge did not is readily apparent. It is because we addressed and resolved these arguments on a generic basis before the judge issued his

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[34] *See infra* note 71.

[35] All the intervenors made the first argument, and some also made the second while others made the third. The staff made all three arguments.

decision.[36] We did so in Order No. 380.[37] In that order, we held that all minimum commodity bill provisions that, like Transwestern's, operate to recover variable costs and all provisions that, like the minimum take provision in Transwestern's service agreement with Pacific, compel a customer to take and pay for a specified minimum volume of gas are unlawful because they permit piplelines to charge customers for costs not actually incurred and restrain, without adequate justification, competition among pipelines by forcing the customers of one pipeline to buy gas from it when less costly gas is available from other pipelines. Accordingly, we ruled that all existing rate schedules and tariffs shall be inoperative to the extent they provide for a minimum commodity bill that recovers variable costs or require a customer to physically take a minimum amount of gas.

The judge, however, did address the argument that Transwestern's minimum bill and minimum take provisions unduly discriminated against Pacific and unduly favored Northwest Central. He found that they did. Because they did so, the judge concluded that Transwestern's minimum bills "in their entirety" were unlawful and had to be modified. The judge also noted that, because of the settlement, Transwestern's minimum bills would be modified on a prospective basis only. Transwestern, our staff, the California Public Utilities Commission (CPUC), GSC, Northwest Central, and Pacific except.

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[36] *See* 29 FERC at 65,156.

[37] *Elimination of Variable Costs from Certain Natural Gas Pipeline Minimum Commodity Bill Provisions,* Order No. 380, 27 FERC ¶ 61,318, FERC Stats. & Regs. ¶ 30,571; Order No. 380-A, 28 FERC ¶ 61,175, FERC Stats. & Regs. ¶ 30,584; Order No. 380-B, 29 FERC ¶ 61,076; Order No. 380-C, 29 FERC ¶ 61,077, FERC Stats. & Regs. ¶ 30,606; Order No. 380-D, 29 FERC ¶ 61,332 (1984), *appeal docketed sub nom. Wisconsin Gas Co.* v. *FERC* No. 84-1358 *et al.* (D.C. Cir. July 30, 1984).

GSC contends that the judge erred in failing to address the argument that Transwestern's minimum bills are unlawful because they require customers to pay Transwestern for costs it does not incur. In making this argument GSC recognizes, as it must, that in Order No. 380 we held that all minimum bills are unlawful to the extent they require customers to pay for costs not incurred. Nevertheless, GSC argues that the judge should have made that same finding based on the record here. The argument is that a case-specific finding is necessary to provide Transwestern's customers with "the additional protection that a case-specific determination of the applicability of relief equivalent to that of Order No. 380 to Transwestern would provide" if Order No. 380 is overturned on appeal.[38]

The problem with this argument, however, is that we resolved by rule the issue concerning the inclusion of variable costs in the rate used to calculate minimum bills in part to simplify numerous cases then pending before us and our administrative law judges.[39] Hence we cannot fault the judge for doing what we intended.[40] And we cannot see what is to

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[38] Brief on Exceptions for GSC at 17.

[39] Order No. 380, slip op. at 46; Order No. 380-A, slip op. at 51.

[40] GSC disputes this point. It argues that in light of Order No. 380 the judge had a "duty" to consider the argument concerning the inclusion of variable costs in the rate. To support this argument GSC quotes our statment in Order No. 380, slip op. at 51, that ongoing cases "will obviously be affected. . . . This does not mean, however, that any of these cases will necessarily be terminated. . . . [T]he Commission expects ongoing cases to continue and leaves to the respective Administrative Law Judge the ordinary responsibility for managing each case."

This argument is disingenuous. GSC has taken our statement out of context. When read in full our statement makes clear that ongoing cases will continue because they present issues, such as the type of fixed costs to be included and the volumes to which the minimum bill applies, in addition to the issue of the inclusion of variable costs in the minimum bill's commodity rate.

be gained now by covering in this case the same ground we have already covered in Order No. 380.[41]

GSC, our staff, Northwest Central, the CPUC, and Pacific, argue that the judge erred in interpreting the settlement as precluding retroactive relief.[42] Whether there is any merit to these exceptions is a question we need not answer. After the parties filed their briefs, they entered into an uncontested settlement that provides in pertinent part that our decision on Transwestern's minimum bills will not be effective before we issue a final order. Since for reasons set forth below we have decided to approve the settlement, there is no retroactive relief we can order with respect to Transwestern's minimum bills. Accordingly, the exceptions to the judge's holding that there will be no retroactive relief are moot.

Transwestern's exceptions are more extensive. It first contends that the judge's order exceeds the Commission's authority. Its argument is this: "The minimum bill provisions define the character of the service we provide. Since that service is provided pursuant to certificates, the judge has partially revoked our certificate. That he cannot do

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[41] As we pointed out in Order No. 380, slip op. at 49 n. 53, if we were "to proceed case-by-case to consider every minimum bill in every existing pipeline tariff, the issues would boil down to the same ones considered in this rule, and the results could be expected to be the same as the result reached in this rule." This case is not an exception.

[42] Pacific made known its position on this point in its brief on exceptions, which, pursuant to Rule 711(a)(1)(iii), was filed on the same day as briefs opposing exceptions. Transwestern has asked us to permit it to file a supplement to its brief opposing exceptions in order to respond to some new facts and arguments in Pacific's brief. We have examined the supplement and will permit the first two pages to be filed. In these pages Transwestern simply responds to the new matters in Pacific's brief. The remaining four pages, however, go beyond anything in Pacific's brief. Accordingly, we will not permit these pages to be filed and will not consider them.

except after a proceeding held under section 7 of the Natural Gas Act. This was not such a proceeding." We disagree.

It is of course true that the Commission, acting pursuant to section 7(e) of the Act, conditioned the issuance of Transwestern's certificates on the inclusion of the minimum bills in Transwestern's initial rates.[43] Still, the minimum bill provisions are tariff provisions. Consequently, as we held in Order No. 380-A,[44] these provisions are fully subject to our power under sections 4 and 5 of the Natural Gas Act "to review rates and contracts made in the first instance by the natural gas companies and, if they are determined to be unlawful, to remedy them."[45]

Second, Transwestern contends that the law judge erred in failing to recognize that the minimum bill and minimum take provisions were established by agreements with Pacific and Northwest Central. According to Transwestern, this fact means the provisions can only be modified upon a showing of "unequivocal public necessity" or "extraordinary circumstances", specifically a showing that the minimum bill and minimum take provisions have impaired the financial ability of Pacific and Northwest Central to provide service to their customers, cast an excessive burden upon other customers, or are unduly discriminatory. To support this proposition Transwestern relies on *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956) and *FPC* v. *Sierra Pacific Power Co.*, 350 U.S. 348 (1956).[46]

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[43] *See supra* pp. 5-6.

[44] Order No. 380-A, slip op. at 8-9.

[45] *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332, 341 (1956).

[46] In its brief on exceptions, at pages 27-28, Transwestern relies on a number of other cases: *Permian Basin Area Rate Cases*, 390 U.S. 747, 822 (1968); *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 582 (1981); *City of Oglesby* v. *FERC*, 610 F.2d 897, 903 (D.C. Cir. 1980); *Metropolitan Edison Co.* v. *FERC*,

This argument is without merit. The two cases upon which Transwestern relies establish a simple doctrine, known as the *Mobile-Sierra* doctrine. The doctrine applies where the natural gas company has bargained away the freedom it has under section 4 of the Act to file unilaterally changes in its tariff. In such a situation the *Mobile-Sierra* doctrine provides that the Act does not empower the Commission to relieve the company of its bargain except where the bargain is inconsistent with the public interest, as where the bargain impairs the ability of the company to provide service, casts an excessive burden on other customers, or is unduly discriminatory.[47]

Thus, for the *Mobile-Sierra* doctrine to apply the agreement between the company and the customer must provide that no changes will be made in the tariff.[48] Transwestern's agreements with Pacific and Northwest Central provide just the opposite. Each provides that Transwestern may change the rate or the form of the tariff at any time and that the customer may also seek to have the rate reduced.[49] Hence the *Mobile-Sierra* doctrine with its stringent burden of proof does not apply here.

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595 F.2d 851, 856 (D.C. Cir. 1979); *Town of Alexandria* v. *FPC*, 555 F.2d 1020, 1030 n.55 (D.C. Cir. 1977). These cases add nothing but a string cite to the argument. Each simply applies the doctrine established by the two cases cited in the text.

[47] *Sierra Pacific Power Co.* v. *FPC*, 350 U.S. at 355.

[48] *United Gas Pipe Line Co.* v. *Memphis Light, Gas and Water Div.*, 358 U.S. 103 (1958).

[49] *See* Art. 3.2 in each of the service agreements. Exh. 91.

The service agreement underlying Rate Schedule CDQ-2, dated October 15, 1965, provides that neither Transwestern nor Northwest Central can seek a change in rate during the first six years of the contract. Thus, during that period the *Mobile-Sierra* doctrine did apply. But it no longer does.

Third, Transwestern contends that the initial decision is fatally flawed because the law judge placed the burden of proof on it. According to Transwestern, it does not bear the burden of proof because it did not seek to change its minimum bill provisions. Instead, Transwestern argues, the burden is on the intervenors and the staff because they seek to change the minimum bill provisions. We disagree.

Transwestern started this case by filing increased rates pursuant to section 4 of the Act. The minimum bill provisions are, as the law judge held, integral to the manner in which the increased rates are charged. In a circumstance such as this the Act places the burden of justifying the minimum bill provisions on Transwestern.[50]

But this is really an academic point. Even if the burden were on the intervenors and the staff to show that the minimum bill provisions are unlawful, that burden has been met. The record shows beyond any serious doubt that, as the judge concluded, Transwestern's minimum bill provisions unduly discriminate against Pacific and unduly favor Northwest Central.[51] It is to this evidence that we now turn.

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[50] *North Penn Gas Co.* v. *FERC*, 707 F.2d 763 (3rd Cir. 1983); *Lacleade Gas Co.* v. *FERC*, 670 F.2d 38 (5th Cir. 1982); *Cities of Batavia* v. *FERC*, 672 F.2d 64 (D.C. Cir. 1982).

[51] In reaching this conclusion the judge relied in part on the fact that Pacific was required to take physically at least 80 percent of its daily contract demand while Northwest Central was not so required. Transwestern argues the judge erred even in considering the physical take requirement applicable to Pacific. Transwestern argues that the lawfulness of this requirement was not one of the issues the settlement reserved for trial.

We need not address this argument. In Order No. 380 and Order No. 380-C, we held that all provisions that require a customer to take a minimum amount of gas are unlawful and hence inoperative. Our order became effective on November 1, 1984. Since our order in this case will be effective prospectively only, nothing we do here will have any effect on the minimum take requirement applicable to Pacific. It is already gone.

Transwestern is obligated to deliver about 1,000 MMcf per day to two customers, 750 MMcf per day to Pacific and 250 MMcf per day to Northwest Central. On an annual basis Northwest Central must take or pay for 90 percent of the contract demand; Pacific must take or pay for 91 percent. In addition, the contract demand used to calculate Northwest Central's minimum bills can be, and has been, reduced because of Transwestern's failure to deliver on average in any year the daily contract amount; Pacific's contract demand remains fixed. Thus, Northwest Central's obligation to Transwestern is to purchase on an annual basis anywhere from 59 percent to 100 percent of the 25 percent of Transwestern's annual supply of gas dedicated to it; Pacific's obligation is to purchase on an annual basis anywhere from 91 percent to 100 percent of the 75 percent of Transwestern's annual supply dedicated to it.

These are significant differences that disadvantage Pacific. Unless justified by the facts, these differences are unlawful under section 4(b) of the Act.[52] But, as the judge correctly held, they have not been.

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Hence we need not and will not determine here whether the requirement is unduly discriminatory.

[52] *Public Service Company of Indiana* v. *FPC*, 575 F.2d 1204, 1212 (7th Cir. 1978).

Under section 4(b) no showing need be made that the discrimination injures the victim before the company is required to justify discrimination. "The essence of the principle is that those who are similarly situated must be treated equally regardless of their ability to survive otherwise." *Florida Gas Transmission Co.*, Opinion No. 807, *reh'g denied*, Opinion No. 807-A, *aff'd sub nom. Sebring Utilities Comm'n* v. *FERC*, 591 F.2d 1003 (5th Cir. 1979), *cert. denied*, 444 U.S. 879 (1979).

Nevertheless, the injury to Pacific and ultimately the consumers in southern California the discrimination causes is clear. It is worth pointing out at least one aspect of the injury.

Transwestern does not have sufficient firm supplies available to it to meet its obligations to deliver 1,000 MMcf per day to its two customers. In 1982 it had only about 750 MMcf of firm

Transwestern, Northwest Central, and GSC except to this conclusion. They argue that the difference is justified. Their primary argument is that Pacific and Northwest Central are not similarly situated customers. They point out that these

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supplies. Tr. 1217, 1224. If that supply were divided between Pacific and Northwest Central in proportion to Transwestern's obligations to each, Transwestern would deliver about 562.5 MMcf per day to Pacific, which is far below its minimum bill obligation of 682.5 MMcf per day (.91 × 750 MMcf), and about 187.5 MMcf to Northwest Central, which is above its minimum bill obligation of about 147.5 MMcf per day (.59 × 250 MMcf). If Transwestern had delivered only 562.5 MMcf per day to Pacific in 1982, the minimum bill would have required Pacific to take or pay for all of it. *See supra* p. 8. But Pacific could then have bought more lower priced gas from El Paso than it did. Since Northwest Central had lower-priced gas available to it and needed only to take or pay for 147.5 MMcf per day, it could and did reject without penalty about 40 MMcf per day. This enabled Transwestern to deliver an additional 40 MMcf per day to Pacific, which, under the minimum bill, had to take the gas or pay for it. This reduced Pacific's ability to buy cheaper gas from El Paso. Thus, the consequence of the discrimination was to increase the cost of Pacific's and SoCal's gas and ultimately, of course, the cost to consumers in southern California.

Even more egregious, Transwestern bought interruptible gas to meet its total certificate obligations. Exh. 1, p. 13. (In 1982 interruptible gas accounted for 14 percent of Transwestern's purchases. *Id.*) By its very nature this is gas that Transwestern need not take to avoid incurring take-or-pay liabilities to its producers. Tr. 1027, 1105. The price of this gas is higher than Transwestern's system average gas costs. Tr. 1230-34. Since Northwest Central did not have to take all of the firm supplies available to it from Transwestern, it did not take any of the interruptible gas Transwestern had bought in part to meet its certificate obligation to Northwest Central. This enabled Transwestern to deliver enough gas to meet its minimum bill obligations of delivering at least 682.5 MMcf per day to Pacific. (In fact Transwestern's deliveries to Pacific in 1982 amounted to about 733 MMcf per day on average. Exh. 83.) As a consequence Pacific's minimum bill was fully in force. Thus, the result of the discrimination was that Pacific had to reduce its purchases of lower priced gas so that it could take higher priced interruptible gas that Transwestern itself did not have to take.

customers operate in entirely different markets, half a continent apart. They also point out that Pacific sells all its gas to its affiliate, SoCal, which is served by other pipelines and is regulated by the CPUC. Northwest Central, on the other hand, has, according to Transwestern, "a large base of low-cost gas in the Hugoton field. It is regulated by the FERC. It also has substantial commitment with producers involving take requirements not affected by Order Nos. 380, *et seq.*"[53]

This argument is not persuasive. There are two problems with it. The evidence of record shows that Northwest Central and Pacific are similarly situated. Both receive firm service from Transwestern. Both also buy gas from producers and other pipelines, some of which sell gas at a lower price than Transwestern does. And both now have more gas available from their suppliers than they need to meet demand. Second, although the differences Transwestern and its supporters point to undoubtedly exist, nothing in the record or even in the briefs explains why these differences justify any difference in the minimum bills applicable to Pacific and Northwest Central, let alone the specific differences that do exist. Without the latter showing we cannot find the differences justified.[54]

Transwestern also contends that the short answer to the law judge's holding is that all its "supply arrangements were filed with, reviewed and approved by the Commission."[55] This is true. But it is irrelevant. The question of whether Transwestern's minimum bill provisions unduly discriminated against Pacific does not appear to have been

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[53] Brief an Exceptions for Transwestern at 31.

[54] *Public Service Company of Indiana* v. *FPC*, 575 F.2d at 1212 (The Commission "must show not only that factual differences justify some rate difference, but also that the factual differences justify the specific rate differences permitted.")

[55] Brief on Exeptions for Transwestern at 31 (footnote omitted).

raised in the prior proceedings, and we have never considered the issue before.[56]

Finding then that the differences between Transwestern's minimum bills applicable to Pacific and Northwest Central have not been justified, we affirm the judge and hold that Transwestern's minimum bills are unduly discriminatory and therefore unlawful.[57]

## V. THE REMEDY

Having found Transwestern's minimum bills unlawful, the law judge had to decide what, if anything, should be put in their place. On this question the near unanimity of the parties broke down. Their proposals pretty much covered the field. The major contenders for the judge's attention, however, were four:

(1) El Paso recommended that the minimum bills and minimum take requirements be reduced to 60 percent of contract demand. In conjunction with this proposal El Paso recommended a change in the way

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[56] In any event, the Commission's prior approval of Transwestern's tariffs neither limits our power to find undue discrimination now nor prevents us from remedying the undue discrimination found to exist. *See, e.g., North Penn Gas Co.* v. *FERC*, 707 F.2d at 767.

[57] Transwestern argues that the record not only lacks evidence showing the minimum bills to be unlawful but also shows the minimum bills to be lawful because they enable Transwestern to remain a viable supplier, avoid take or pay problems, and contract for gas supplies. Brief on Exceptions for Transwestern at 31-32. The problem with this argument is that, even if the record showed what Transwestern contends it shows, this evidence would not justify the unlawful discrimination between Pacific and Northwest Central.

Equally unavailing is Transwestern's argument that the judge's holding is unsupported because the record does not contain any evidence on the impact of Order No. 380. The unlawful discrimination between the minimum bills applicable to Pacific and Northwest Central exists whether or not variable costs are included in the minimum bills' commodity rates.

Transwestern's costs are classified and allocated and its rates designed. According to El Paso, all of Transwestern's fixed costs except for return on equity and related income taxes should be classified to the demand component and recovered through the demand rate. Return on equity and related income taxes, together with all variable costs, would be classified to the commodity component and recovered through the commodity rate.[58]

(2) Pacific and the CPUC recommended that the minimum bill and minimum take provisions be reduced to 35 percent of the contract demand.[59] Pacific also recommended that the method used to classify and allocate Transwestern's costs and design its rates be changed in the same way El Paso recommended. Finally, Pacific recommended that the sales volumes used to calculate the commodity rate be set to provide Transwestern with an incentive to keep the price of the gas low and that a special, lower commodity rate be applied to any sales above the design level.[60]

(3) Northwest Central recommended that the minimum bill be reduced to 50 percent of the contract demand quantity used in calculating the minimum bill.[61] Since the contract demand quantity used in calculating Northwest Central's minimum bill is only about 59 percent of the volumes Transwestern is required to deliver under its certificate, adoption of this recommendation would mean that Northwest Central's obligation under the minimum bill would be to take or pay for only about 30 percent of the volumes Transwestern is required to deliver.[62] Under this recommendation Pacific's obligation, however, would be to take or pay for 50 percent of the volumes.

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[58] *See* Exh. 55, pp. 22-24.

[59] *See* Exh. 38, p. 13; Exh. 45; Exh. 46; Exh. 84, p. 7.

[60] *See* Exhs. 45 and 46.

[61] Exh. 67.

[62] *Id.* at p. 7.

(4) The staff and the Governor of California recommended that the minimum bills and minimum take provisions be eliminated.[63] The staff also recommended, however, a change in the way Transwestern's costs are classified and allocated and its rates designed. The staff's proposal was similar to El Paso's. But there were two significant differences. First, the staff classified fixed production costs as well as return on equity and related income taxes to the commodity component. Second, the staff allocated only 50 percent of the demand costs on the basis of peak responsibility. The other 50 percent the staff allocated on the basis of annual usage to recognize the fact that demand costs are incurred to provide service at peak as well as service throughout the year.[64]

The judge concluded that none of these recommendations was supported by the record evidence. Accordingly, the judge rejected them all. Nevertheless, the judge adopted a variant of El Paso's recommendation. Specifically, he held that Transwestern's minimum bill should be reduced to 60 percent of the contract demand.[65]

The reason the judge adopted a 60 percent minimum bill was because he concluded that Transwestern and El Paso should be placed on an equal footing to permit them to

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[63] Exh. 85, p. 40; Exh. 70.

[64] Exh. 85, pp. 22-25.

[65] 29 FERC at 65,164. The judge did not adopt El Paso's recommendation to change the way Transwestern's costs are classified and allocated and its rates designed. *Id.* With respect to Northwest Central, the initial decision is not explicit on whether the contract demand to which the 60 percent minimum bill would apply is the reduced contract demand presently used in calculating the minimum bill or the unadjusted contract demand of 250,000 Mcf per day. Nevertheless, the judge's ruling is clear. He intended the latter. This is so because he intended to eliminate the undue discrimination between Pacific and Northwest Central. 29 FERC at 65,163. Using the reduced contract demand would perpetuate the discrimination.

compete freely in the southern California market.[66] Because El Paso had conditionally agreed to put into effect a 60 percent minimum bill for Pacific, the judge held that Transwestern's minimum bill had to be reduced to 60 percent.[67]

Transwestern, our staff, the Governor of California, and the CPUC except.[68] They argue that for a variety of reasons the judge erred by imposing this minimum bill requirement. We agree.

The fundamental problem with the judge's recommendation, as well as the recommendations of El Paso, Pacific, and Northwest Central, is that it continues to impose a minimum bill.

The effect of a minimum bill is to restrain trade, for it forces a customer to buy gas from one pipeline rather than other pipelines, thereby foreclosing competition for that customer's business. In certain situations this restraint may, if there is inadequate justification for it, amount to an unreasonable and therefore unlawful restraint of trade.[69] In Order

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[66] *Id.*, at 65,163.

[67] 29 FERC at 65,158.

El Paso initially proposed to reduce the minimum bill in a settlement in *Pacific Gas Transmission Company,* Docket No. RP83-113. By an order issued this day we have finally approved the settlement. *Pacific Gas Transmission Co.,* 31 FERC .....

[68] Northwest Central also excepts to this aspect of the initial decision. It argues that the judge erred in not adopting a settlement between it and Transwestern. We need not address this argument, for Northwest Central has since withdrawn the settlement. *See infra* note 108.

[69] A minimum bill is in effect a requirements contract. A requirements contract is unlawful under section 3 of the Clayton Act, 15 U.S.C. § 14 (1982), if the effect of the contract "may be to substantially lessen competition or tend to create a monopoly in any line of commerce." A requirement contract may also be unlawful under section 1 of the Sherman Act, 15 U.S.C. § 1, if it amounts to a "restraint of trade" within the meaning of that act.

No. 380 we found that minimum bills did unreasonably restrain trade to the extent they permitted pipelines to recover costs not incurred and required customers physically to take a specified amount of gas. We therefore ordered pipelines to modify their minimum bills accordingly.[70]

That we have ordered pipelines to modify their minimum bills to exclude variable costs from the commodity rate and eliminate physical take provisions does not mean we can assume the minimum bills that remain, such as Transwestern's, are reasonable and lawful. They still may adversely affect competitors and consumers by foreclosing competition and restraining trade. And that will be the probable consequence of imposing a minimum bill on Transwestern's

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It has long been recognized that requirements contracts may serve useful functions. *Standard Oil Co.* v. *United States*, 337 U.S. 293, 306-7 (1949). Hence the courts have not subjected requirements contracts to a *per se* analysis, which would condemn all requirements contracts. Rather, the courts have subjected them to a rule of reason analysis. Under this type of analysis a requirements contract is unlawful only if it is "more restrictive than necessary to meet an objective meriting antitrust recognition." 3 Areeda and Turner, Antitrust Analysis ¶ 731 (1980).

The Commission also uses the rule of reason analysis in assessing the reasonable of a requirements contract in a rate schedule or tariff, modifying it only to the extent that we must in order to take into account objectives meriting recognition under our own statutes in light of the alternatives available for meeting those objectives. *See Kentucky Utilities Co.*, Opinion No. 169, 23 FERC ¶ 61,317, at 61,675, *reh'g denied*, Opinion No. 169-A, 25 FERC ¶ 61,205 (1983), *appeal on other issues docketed*, No. 84-3014 (6th Cir. Jan. 6, 1984).

[70] *See* supra pp. 14-15.

In Order No. 380-A, slip op. at 49-50, the Commission expressly noted that Transwestern's minimum bills had caused serious problems for its customers and competitors. The record in this case amply supports that conclusion. *See* supra pp. 10-12.

two customers.[71] Hence any minimum bill recommendation

[71] Since Order No. 380 was issued after the record in this case closed, this judgment is not based on the specific testimony of any one witness. But we do not need to have such testimony to form a judgment. *See Market St. Ry. Co.* v. *R.R. Comm'n of California,* 324 U.S. 548, 559-61 (1948). The evidence in the record, our knowledge of the industry, and common sense lead to the conclusion that any minimum bill for Transwestern will have adverse consequences for its competitors and customers. The factors that lead us to this conclusion are:

(1) As we have shown above, *supra* pp. 10-11, gas supplies available in the southern California and Kansas City markets have exceeded demand for the past few years. This situation is likely to continue. (Pacific estimates that during the five year period from 1983 through 1987 SoCal will need on average every day between 2,620 MMcf and 2,925 MMcf. Exh. 43. The gas available to Pacific during these years is estimated to be over 3,000 MMcf per day, specifically 1,750 MMcf from El Paso, 750 MMcf from Transwestern, 240 MMcf from Pacific Interstate Transmission Company, Exh. 51, p. 4 and Tr. 3059, about 200 MMcf from intrastate producers, Exh. 43, and about 70 MMcf from Federal Offshore producers, Tr. 2238-40. The record is not as well developed with respect to Northwest Central. But nothing in the record suggests a turn around in its market.)

(2) In situations where a market's supply equals its demand, a requirements contract may not be competitively significant. Its effect may be simply to shift the pattern of buyer-seller relationships, for a seller that is committed to supply the requirements of one customer has that much less supply to devote to others. 3 Areeda and Turner, *supra* note 69, at ¶ 732(c). But in a situation where supply exceeds demand a requirements contract has competitive significance, for the effect is to foreclose competitors from the market. El Paso's experience in the southern California market in 1982 amply demonstrates this point. *See supra* p. 12.

(3) It is not certain that a minimum bill that recovers only fixed costs will have the same effect as Transwestern's minimum bills had in 1982. But it may. Assume, as the record suggest, Exh. 33, that with no minimum bill Pacific would buy at least 413 MMcf per day, or about 55 percent of its ACQ. Assume further that a minimum bill is imposed, which like the judge's recommendation, would require Pacific to take or pay for 450 MMcf per day, or 60 percent of the ACQ. Pacific would buy the 37 MMcf difference from another supplier only if it could save money. And Pacific could save money only if the

for Transwestern must be justified. But none has been on this record.

The Commission has identified three factors that may justify a minimum bill.[72] First, a minimum bill may be justified as a means of protecting the pipeline against the risk of not recovering the fixed costs in the commodity component. Second, a minimum bill may be justified as a means of protecting full requirements customers from bearing a disproportionate share of the fixed costs resulting from swings off the system by partial requirements customers. And third, a minimum bill may be justified as a means of protecting customers from take-or-pay liabilities the pipeline might otherwise incur. Since Pacific and Northwest Central are partial requirements customers, the second possible justification is not applicable here. Hence we need only consider the first and third possible justifications.

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total of the commodity charges it would pay the alternate supplier and the minimum bill it would pay Transwestern is less than the commodity charges it would pay to Transwestern.

If Transwestern gas costs are significantly higher than its competitor's, the penalty a fixed cost only minimum bill would impose may not be high enough to deter Pacific from buying from another supplier. Thus, the minimum bill may not foreclose the market to the other supplier. But even if the minimum bill does not have this effect, it still will have adverse consequences on competition. To become competitive Transwestern will not have to reduce the price of its gas to the level of its competitor's price. Instead, all Transwestern will have to do is to reduce the price of its gas so that it equals the price of its competitor's gas plus the minimum bill payments. This will result in an inefficient allocation of resources. This needs to be justified.

[72] Order No. 380, slip op. at 9. *See also* Notice of Proposed Rulemaking, FERC Stats. & Regs. ¶ 32,334, at 32,669 (1983), and *Atlantic Seaboard Corp.*, Opinion No. 553, 38 FPC 91, 95 (1967), *aff'd*, 404 F.2d 1268 (D.C. Cir. 1968).

The minimum bill proposals before us appear to satisfy the first justification. Transwestern developed the rates presently in effect using the *Seaboard* method.[73] Under this method, as we have noted, 50 percent of Transwestern's fixed transmission costs are recovered through the commodity component. The minimum bill proposals assure recovery of these costs up to a certain limit. But in fact the proposals do not satisfy this justification. There are two reasons.

First, the point of this justification is not simply to assure the recovery of fixed costs. If it were, a 100 percent minimum bill would be justified in all cases. That is obviously incorrect.[74] And no one contends otherwise. Instead, the point of the justification is to balance the incentives to minimize long term costs competition provides against the fact that gas pipelines have high fixed costs.[75] The problem we have with the minimum bill proposals before us is that we cannot determine whether they strike a reasonable balance. Simply put, they are too crude. In light of the justification's purpose, the most that can be said about the amount of fixed costs whose recovery should be assured is that the amount should be no greater than the costs of depreciation and of servicing the debt. It must also be said that in light of the justification's purpose the amount of fixed costs whose recovery should be assured should in no way act to assure recovery of the return on equity, related income taxes, and fixed production costs. These elements of the cost of service should be at risk to give the pipeline an incentive to

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[73] *See supra* note 18.

[74] In *Transwestern Pipeline Co.*, Opinion No. 328, 22 FPC at 394, the Commission rejected Transwestern's proposal to include a 100 percent minimum in its initial rate schedule for Pacific.

[75] *See Atlantic Seaboard Corp.* v. *FPC*, 404 F.2d at 1272-73.

minimize its costs.[76] The minimum bill proposals before us, however, do not attempt to limit the payments to be made under the minimum bills to amounts that reflect the costs of depreciation and of servicing the debt. Instead, they simply multiply the fixed costs included in the commodity component by a certain figure. Nothing in this record allows us to conclude that payments determined in this way will be no greater than are warranted by the justification.

Moreover, a minimum bill is unnecessary to assure recovery of the amount of fixed costs Transwestern should recover. The staff, Pacific, and El Paso have proposed using a modified fixed-variable methodology to develop Transwestern's rates. Under this method all fixed costs except return on equity, related income taxes, and, perhaps, production related costs, are classified to the demand component and recovered through the demand rate. Thus, Transwestern would be assured of recovering all of the fixed costs it should recover without having to impose a minimum bill.[77]

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[76] *See Texas Eastern Transmission Corp.*, 30 FERC ¶ 61,144, at 61,269 and 61,283, *reh'g granted for purposes of further consideration*, 31 FERC ¶ 61,049 (1985); *Natural Gas Pipeline Co.*, 25 FERC ¶ 61,176 at 61,482-83 (1983), *reh'g denied* 26 FERC ¶ 61,203 (1984), *appeal docketed sub nom. Northern Indiana Publ. Serv. Co.* v. *FERC*, No. 84-1416 (7th Cir. March 19, 1984).

[77] We note that the Court of Appeals for the District of Columbia Circuit recently reversed this Commission's order approving a fixed cost only minimum bill in part because there was no evidence showing that the minimum bill was needed to recover fixed costs. *Mississippi River Transmission Corp.* v. *FERC*, No. 84-1046, *et al.* (April 19, 1985). It can be argued that the court's decision requires more evidence to justify a minimum bill than we have required here. We have not applied the court's decision to this case for two reasons. First, we still are assessing the decision. Secondly, even under the arguably less stringent standard we have used here, we find the minimum bill proposals do not satisfy the first justification.

With respect to the third possible justification, there is a great deal of confusing argument and disputed evidence concerning the take-or-pay liabilities Transwestern might incur if its minimum bills, as they existed when this proceeding began, were changed. The judge concluded that, because the changes in Transwestern's minimum bills wrought by Order No. 380 were not reflected in the evidence, none of it could be relied on.[78] This is largely true.[79] Transwestern argues that because this is so, the record is incomplete. Hence, Transwestern contends, our only alternatives are either to approve its minimum bills as they now stand or to re-open the record. We disagree. The evidence is irrelevant. It is used either to argue or to rebut the argument that minimum bills of a certain level are justified because they will foreclose competition for Pacific's and Northwest Central's business and thereby prevent Transwestern from incurring take-or-pay liabilities. This is not the point of the third justification.[80] Rather, the point of the justification is that a minimum bill may be permissible if it is used to ensure that the carrying costs associated with take-or-pay liabilities will be borne by the customers that caused the liabilities to be incurred.[81]

This subject the parties have declined to address. The reason for their silence is not mysterious. Anything they did

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[78] 29 FERC at 65,162.

[79] *But see* Exhs. 32 and 33 (discussed *supra* note 71).

[80] Indeed, in Order No. 380, slip op. at 42, the Commission stated that to the extent minimum bills have the effect of preventing pipelines from incurring take-or-pay liabilities by foreclosing competition, they are "anti-competitive, unjust, and unreasonable."

[81] In Order No. 380, slip op. at 9, the Commission stated that the third possible justification is really an "outgrowth" of the second justification. The second possible justification is that minimum bills may be justified as a means of ensuring equitable cost recovery from both full and partial requirements customers.

say would be merely a statement of the obvious, for there is no connection between the minimum bill payments the customers would make and the carrying costs associated with take-or-pay liabilities Transwestern could legitimately recover from them. For example, suppose Pacific reduced its purchases below minimum bill level, be it 91 percent, 60 percent, 50 percent, or 35 percent of its ACQ. This reduction might not cause Transwestern to incur any take-or-pay liability to its suppliers. But Pacific would nevertheless incur a minimum bill liability to Transwestern.[82] Moreover, even if Transwestern did incur take-or-pay liabilities as a result of Pacific's reducing its purchases, there is no connection between the costs Transwestern could legitimately recover from Pacific and the minimum bill payments it would receive. In short, there has been no showing here that any of the minimum bills proposed for Transwestern are justified on the grounds that they will assure equitable recovery of the carrying costs of take-or-pay liabilities.

In addition to these traditional justifications for minimum bills, the judge has added another. It is that in order to avoid placing a pipeline in economic jeopardy by subjecting it to a governmentally-created competitive disadvantage a pipeline must be placed on an equal footing with its competitor.[83] Hence, if a pipeline's competitor has a minimum bill at a certain level, the pipeline should have a minimum bill at the same level. Following this theory the judge held that, since Transwestern's major competitor in the southern California market, El Paso, had agreed to use a 60 percent minimum bill in its rate schedules for sales to Pacific, Transwestern should have a 60 percent minimum bill. To support his

[82] Conversely, Transwestern might incur, as it has asserted it would, take-or-pay liabilities even if Pacific purchased gas at minimum bill levels. But Pacific would then not incur any minimum bill liability to Transwestern.

[83] 29 FERC at 65,162-63.

justification the judge relied on the fact that, when the Commission first issued a certificate to Transwestern to sell gas to Pacific in 1959, it granted Transwestern's request to include a 91 percent minimum bill in the initial rate schedule because El Paso also had a 91 percent minimum bill.[84]

This justification has some appeal. Nevertheless, we decline to adopt it. We do so because the reasons that can be offered in support of it are themselves either unsupportable or unsupported.

One reason is fairness. It is this that gives the justification its appeal. But in this area of the law the general rule is that a just and reasonable minimum bill for a pipeline must be based on the facts of that pipeline, not the minimum bills of its competitors.[85] The reason for the rule is obvious. To set just and reasonable rates requires a decision as to what is fair to both the pipeline and consumers.[86] To set the pipeline's minimum bill on the basis of the minimum bills other pipelines have eliminates consumers as a factor to be considered. This we decline to do.

Another reason is that in 1959 the Commission allowed Transwestern to put into effect a minimum bill of 91 percent because El Paso had a 91 percent minimum bill. The problem with this reason is that the Commission's 1959

[84] *Transwestern Pipeline Co.*, Opinion No. 328-A, 22 FPC at 543.

[85] *Atlantic Seaboard Corp.*, 38 FPC at 96.

[86] This principle is of ancient lineage. It was recognized as early as 1912 by Justice Holmes, who said that regulation "has to steer between Scylla and Charybdis. On the one side, if the franchise is taken to mean that the most profitable return that could be got, free from competition, is protected by the Fourteenth Amendment, then the power to regulate is null. On the other hand, if the power to regulate withdraws the protection of the amendment altogether, then the property is nought. This is not a matter of economic theory, but of fair interpretation of a bargain. Neither extreme can have been meant. A midway between them must be hit." *Cedar Rapids Gas Light Co.* v. *Cedar Rapids*, 223 U.S. 655, 669 (1912).

decision was not a pronouncement that Transwestern and El Paso should always have the same minimum bills. Rather, the Commission's decision was necessitated by, and based on, the specific circumstances existing at that time. In 1959 Transwestern was a new pipeline company proposing to enter a market that had for some time been dominated by one major supplier, El Paso, which could sell gas at a lower price than Transwestern. In a situation like that, it is apparent that, if Transwestern were to have a chance of securing financing to build its pipeline and thereby introduce some competition into the southern California gas market, it needed, as it then argued to the Commission, the assurance of a market for its gas that a minimum bill equal to El Paso's would provide.[87] And that is all the Commission held. It stated simply that a minimum bill equal to El Paso's "would protect Transwestern from discrimination in the event of market fluctuations and insure the financing of its project. . . ."[88]

Moreover, the conditions that in 1959 required allowing Transwestern a minimum bill equal to El Paso's no longer exist. Transwestern is no longer a neophyte in the gas business needing, like any other beginner, a helping hand. It is now an established pipeline. It has been in business for 25 years. Nearly 50 percent of its plant has been depreciated.[89] The securities it issued to construct its pipeline have largely been retired.[90] It has not expanded its

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[87] Exh. 87, p. 14 (Application for Rehearing for Transwestern Pipeline Company in Docket No. G-14871).

Transwestern there stated that its financial advisors had informed it that it could not economically or feasibly market its securities with a minimum bill less than El Paso's.

[88] 22 FPC at 543.

[89] Specifically, as of December 31, 1982, Transwestern's net plant was 52.2 percent of its gross plant. Tr. 1502

[90] Tr. 1578.

system significantly during the five year period from 1978 through 1982.[91] Hence Transwestern has not had to issue long-term debt or equity since 1981.[92] What little construction it has undertaken has been financed with internally generated funds.[93] As a consequence, Transwestern's debt is only about 6 percent of its total capitalization.[94] In addition to these changes in its financial position Transwestern's disadvantage in terms of the price at which it sells gas has disappeared. In 1959 Transwestern's gas sold at a price about 40 percent higher than El Paso's.[95] At the time of the hearing it sold for about 3.6 percent more.[96] And now it sells for less.[97] Given these facts it is hard to see why Transwestern still needs a helping hand to compete.

A third reason is that without a minimum bill equal to El Paso's, Transwestern will be placed in economic jeopardy. We think this is unlikely. The evidence we have just reviewed does not show a company that is in economic

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[91] Statement O(3).

Of more importance is Transwestern's capital expansion in the future. We have almost no idea of what that will be. Our lack of knowledge on this score is not caused by an inadequate record. It is because Transwestern does not know. When asked about Transwestern's capital expansion plans, Transwestern's chief financial officer testified that, "we can't figure out what we are doing in 1983. We certainly don't know what we are doing in 1984." Tr. 2405.

[92] Tr. 2412.

[93] Tr. 2410-11.

[94] According to Transwestern's Form 2 for 1982, Transwestern's capitalization consisted of $18,525,000 in debt, $21,641,500 in preferred, and $263,901,000 in common equity. Tr. 2409.

In addition to these sums Transwestern had about $46 million in accrued but unpaid refunds, *id.*, that it used to finance its capital expansion. Tr. 2410.

[95] Tr. 1494.

[96] *Id.*

[97] *See* Order No. 380-C, slip op. at 14 n. 13.

jeopardy. And we cannot assume Transwestern's existence will be jeopardized. Transwestern estimated that even if it had no minimum bill in 1982, Pacific would still have taken about 55 percent of its annual contract quantity.[98] That estimate was made at a time when Transwestern's gas was priced above El Paso's. Now, as we have noted, Transwestern's gas is priced below El Paso's. Hence it is difficult for us to imagine that Transwestern will not sell substantial amounts of gas in the southern California market even if it has no minimum bill.

Finally, there are two wholly independent reasons we must reject the judge's justification. El Paso's minimum bill was established in a settlement of limited duration. That settlement resolved many issues in addition to the minimum bill issue and no doubt involved considerable give and take on all issues. We neither can nor should require Transwestern to live by one aspect of the compromise El Paso found acceptable to it. Moreover, if we were to adopt the judge's justification, we would have to hold in El Paso's next rate case, should the issue arise, that El Paso is entitled to a 60 percent minimum bill because Transwestern has a 60 percent minimum bill.[99] Thus, as if by transmutation, an uncontested settlement on the minimum bill issue that we accepted to resolve a case would become the just and reasonable minimum bill for El Paso. We will not allow ourselves to be so bound.

To sum up, we find that: (1) the probable effect of including a minimum bill in Transwestern rate schedules will be to foreclose competition or increase prices to consumers or both; (2) the only possible justification on this record for

[98] *See* Exhs. 32 and 33.

[99] El Paso has recently filed a general section 4 rate case. Docket No. RP85-58-000. We suspended the effectiveness of the increased rates until July 1, 1985, and set the matter for hearing. *El Paso Natural Gas Co.*, 30 FERC ¶ 61,097 (1985).

including minimum bills in the rate schedules is that they are needed to assure recovery of fixed costs; and (3) there is an alternative means of assuring recovery of fixed costs. Accordingly, we hold that the inclusion of minimum bills in Transwestern's rate schedules is not justified and that none should be included.

A number of the parties, including Transwestern, argue that, if a substantial change is made in Transwestern's minimum bills, there should be a change made in the method by which Transwestern's costs are classified and allocated and its rates designed.[100] As we have noted, the staff, El Paso, and Pacific put forth recommendations as to what the new method should be. Each of these involved some form of the modified fixed-variable method.[101]

The judge rejected these recommendations. He did so because he found that the recommendations were unsupported and because there had been no showing that the *Seaboard* method, which was used to develop the rates now in effect, was unjust, unreasonable, unduly discriminatory, or preferential.[102]

We disagree with the judge's findings on this issue. First, there is adequate support for the recommendations. This is certainly so for the staff's recommendations. It has been described in detail by the staff's witness.[103] This is also true

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[100] No party argued that the present method used to classify and allocate Transwestern's costs and design its rates should remain unchanged if the minimum bills are substantially changed.

[101] No party opposed using some form of the modified fixed-variable method or proposed a different method, and, subsequent to the filing of their breiefs, the parties entered into an uncontested settlement in which they agreed to use the staff's version of the modified fixed-variable method. We address the settlement below. *See infra* pp. 50-55.

[102] 29 FERC at 65,163-64.

[103] *See* Exh. 85, pp. 24-25, and Exh. 101, p. 3-5.

of El Paso's recommendations[104] and to a certain extent of Pacific's.[105] Second, eliminating the minimum bill is a change in circumstances that renders the *Seaboard* method unjust and unreasonable. As we have noted above, *supra* p. , under the *Seaboard* method 50 percent of Transwestern's fixed costs are recovered through the demand rate and 50% through the commodity rate. With a high minimum bill Transwestern has been guaranteed recovery of almost all its fixed costs. Continuing to use the *Seaboard* method but eliminating the minimum bill would suddenly expose Transwestern to significantly greater risks of not recovering its fixed costs. We think this is unreasonable since the fixed costs that would be at risk include the cost of servicing debt and depreciation.

Thus, we must now decide what method should be used to classify and allocate Transwestern's costs and design its rates. The staff's recommendation is the most fully developed method. This is recognized by the other parties. They accept most of the staff's recommendation, departing from it on only two limited points.

First, El Paso, Pacific, and Transwestern challenge the staff's recommendation to the extent it classifies fixed production and gathering costs to the commodity component. These parties argue that fixed production and gathering costs should be classified to the demand component because these costs are fixed. We disagree. In two recent cases, we recently reviewed the question of how fixed production costs should be classified.[106] We there re-affirmed the Commission's long-standing policy of classifying these costs to the commodity

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[104] Exh. 55, pp. 24-25, Exh. 64-A, pp. 3-8.

[105] Exh. 38, pp. 14-15, Exh. 45.

[106] *Texas Eastern Transmission Corp.*, 30 FERC at 61,269; *Natural Gas Pipeline Co.*, 25 FERC at 61,482.

component. We see nothing in this case that would cause us to depart from that conclusion.

Second, Pacific challenges the staff's recommendation to the extent it develops the commodity rate using test period sales volumes and applies the resulting commodity rate to all sales, be they lower or higher than the test period sales level. Pacific recommends that the sales level should be higher and that the commodity rate to be applied to sales above this level should be based on the cost of purchased gas and fuel plus five cents instead of all the fixed costs classified to the commodity component.

We will not adopt this recommendation. The general rule is that the sales volumes used to develop the commodity rate is selected on the basis of a projection of the sales the pipeline is to make during the test year. Pacific argues that a higher sales level should be used to give Transwestern an incentive to reduce the price of gas. That may be appropriate. But Pacific has not explained how we should adjust the test period sales level to give Transwestern the appropriate amount of incentive.[107] Nor has Pacific explained, let alone supported, the five cents figure used in the commodity rate that would apply to any sales above whatever sales level is adopted. Finally, the proposal is ill-conceived. It would place upon Transwestern the risk of not earning its return if it did not sell the volumes used in developing the rates. But if Transwestern in fact sold more gas than the sales level, the proposal would prevent Transwestern from earning a higher return. Under such circumstances Transwestern would have little incentive to provide service beyond the test period volumes used to develop the commodity rate.

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[107] During cross-examination Pacific's witness suggested using a sales volume of 800 MMcf per day. Tr. 2643. But this was an off-the-cuff estimate without any explanation as to why this level would be appropriate.

## VI. OTHER MATTERS

There are two other matters that require attention. The first concerns the various settlements pending before us. By our count there are four settlements pending before us. Two of the settlements, both between Transwestern and Northwest Central, were certified to us by the law judge in October of 1984. Each of these settlements is opposed by several parties and our staff. We need not, however, address the arguments for and against these settlements, for the settlements have been superseded by the two other settlements, which were filed with us on May 6, 1985 and May 9, 1985.[108] Hence we need only consider the two latter settlements.

The settlement filed on May 6, 1985, is between Transwestern and Northwest Central. The settlement provides essentially that Transwestern will waive the minimum bills in the two rate schedules applicable to Northwest Central to the extent the minimum bills recover non-incurred gas costs. This waiver is effective from July 1, 1982, until the earlier of the date Transwestern has been permitted to place into effect rates which have been filed to reflect our decision here concerning the minimum bills or June 1, 1986. The settlement also provides that Northwest Central will be allowed to include in its PGA account the fixed cost minimum bill amounts as a current gas cost.

There is no opposition to this settlement, and it appears to us that it is fair, reasonable, and in the public interest. Accordingly, we shall accept and approve it.

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[108] On May 6, 1985, Transwestern and Northwest Central moved to withdraw one of the earlier settlements the judge certified to us, and on May 10, 1985, they moved to withdraw the other. Both motions are granted.

The settlement filed on May 9, 1985, is more complex. Its major provisions are:

(1) The reasonableness of Transwestern's minimum bills will be determined by Commission opinion and order in this proceeding.

(2) The Commission's decision in this proceeding concerning Transwestern's minimum bills, cost classification, cost allocation, and rate design will have prospective effect only from the later of the date the order becomes final or the date Transwestern is permitted to place into effect rates designed to reflect the decision.[109]

(3) Transwestern will reduce its minimum bills to 60 percent from July 1, 1985, until the Commission's order in this proceeding becomes effective.

(4) Transwestern will waive its minimum bills to the extent they recover non-incurred gas costs. This waiver is effective on February 28, 1982, and will last until the later of the date the court issues its mandate in the pending appeal of Order No. 380 or June 1, 1986.[110]

Transwestern will also waive the minimum take provision applicable to Pacific from February 28, 1982, until the court issues its mandate in the pending appeal of Order No. 380-C.

(5) Effective July 1, 1985, Transwestern will reduce its cost of service by $5,424,054.

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[109] The settlement defines "final" to mean an order that is no longer subject to rehearing.

[110] This waiver period is somewhat longer than the waiver period in the settlement filed on May 6, 1985. The settlement filed on May 9, 1985, makes clear that, where there is an inconsistency between the two settlements, the terms of the May 9th settlement control. Hence the waiver period for Northwest Central begins on February 28, 1982, rather than on July 1, 1982, and will end on the later of the date the court issues its mandate in the pending appeal of Order No. 380 or June 1, 1986.

(6) Effective July 1, 1985, Transwestern will classify and allocate its costs and design its rates according to the staff's recommended modified fixed-variable method.[111]

(7) Transwestern may redesign its rates to reflect sales volumes that are consistent with our decision concerning the minimum bills.

(8) Transwestern will file as part of the settlement an incentive sales rate schedule that will enable the pipeline to discount the price of volumes sold in excess of minimum bill levels by reducing the commodity charge to not less than Transwestern's variable costs, including gas costs.[112] Transwestern will file any such discount. Such a filing will be deemed not to be a general section 4 filing under the Natural Gas Act. Accordingly, no filing fees need be paid. Acceptance of the settlement constitutes acceptance of the incentive rate schedule.

(9) Transwestern will be permitted to discount the otherwise applicable transportation rate for its sales customers under Rate Schedule TS-1. Any such discount will come out of Transwestern's profit and will be made available to all sales customers. If Transwestern discounts the transportation rate, Transwestern will file such discount. Any such filing will not be deemed to be a general section 4 rate filing. Accordingly, no filing fees will be paid. Since the rates in Rate Schedule TS-1 are based on representative volumes, Transwestern will retain any revenues above the representative volumes. In addition to providing transportation to sales customers, Transwestern will provide transportation to non-sales customers under Rate Schedule TS-2. Since the rates in Rate Schedule

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[111] The resulting rates are set forth in the Twenty-Ninth Revised Sheet No. 5 to the Second Revised Volume No. 1 of Transwestern's FERC Gas Tariff, which Transwestern filed on May 21, 1985.

[112] The incentive sales rate schedule, Original Sheet No. 35 to the Second Revised Volume No. 1 of Transwestern's FERC Gas Tariff, is appended to the settlement as Appendix C.

TS-2 are not based on representative levels, Transwestern will retain $.01 per MMBtu in accordance with 18 C.F.R. § 284.103(d) and credit appropriate amounts to Pacific and Northwest Central.

(10) The service agreement between Transwestern and Northwest Central that underlies Rate Schedule CDQ-2 will be extended from November 4, 1985 through May 31, 1986.

This settlement is supported by Pacific, Northwest Central, GSC, the CPUC, and our staff and is opposed by no party. Our review of the settlement convinces us that, subject to three minor modifications, the settlement is fair, reasonable, and in the public interest.

The first modification that is necessary concerns the effective date of our decision. The settlement provides that our decision will be effective upon the later of the date the order becomes final or the date Transwestern is allowed to place into effect rates that reflect our decision. We have no difficulty with postponing the effective date of our decision until the order becomes final. That is reasonable. Our difficulty is with postponing the effectiveness of our decision until Transwestern is allowed to place in effect rates that reflect it. If we were to permit this, Transwestern could delay the effective date of our decision by delaying the filing of revised rates. Though we have no reason to believe Transwestern will do so, experience persuades us that it is best not to let the subject of our decision determine when it will become effective.

The second modification concerns the provisions of the settlement stating that Transwestern will pay no fees when it files to change the rate under either Rate Schedule ISR or Rate Schedule TS-1. Our policy on this question is clear.[113] When the pipeline files a change to its sales or transportation

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[113] *Southern Natural Gas Co.*, 31 FERC ¶ 61,295 (1985).

rates, the filing fee is due unless the pipeline satisfies the requirements of 18 C.F.R. § 381.106, which provides that the filing fee will be waived only where the "applicant is suffering from severe economic hardship at the time of the application which makes the applicant economically unable to pay the appropriate fee." No such showing has been made here. Accordingly, the settlement must be modified to eliminate the provision that no filing will be paid where a discount to either Rate Schedule ISR or Rate Schedule TS-1 is filed.[114]

The third modification required is to Rate Schedule ISR and Rate Schedule TS-1 themselves. Both rate schedules provided in essence that Transwestern may discount the stated rate at anytime. In addition Rate Schedule TS-1 provides that Transwestern need not give any notice at all to either its customers or to us before the discount takes effect.[115] We have previously considered a company's discount rate schedule similar to Transwestern's. *Southern Natural Gas Co.*, 31 FERC ¶ 61,295 (1985). We there held that the company should not be permitted to discount the stated rate more frequently than once a month and that notice of the discount must be given to us at least five days before the discount is to take effect. We see no reason to depart from that holding here. In conformity with this conclusion we will waive the requirement that any change in rate be preceded by 30 days notice.

In light of the foregoing we shall accept and approve the May 9th settlement subject to the three modifications.

The other matter is Transwestern's motion of May 31, 1985, to reopen the record to reflect changes that have

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[114] Our holding here is without prejudice to Transwestern's seeking a waiver of the filing fee when it files a discount.

[115] Rate Schedule ISR provides that Transwestern will give customers five days notice of any discount.

occurred since the close of the record in July of 1983.[116] The motion is opposed by Pacific, the CPUC, Northwest Central, GSC, and our staff and supported by the East of California customers of El Paso.

We may grant the motion if we find "good cause" exists for reopening the record.[117] We do not find that "good cause" exists.

In so holding we recognize of course that changes have occurred since the close of the record.[118] But such changes always occur. Yet litigation must come to an end at some point. Hence the general rule is that the record once closed will not be reopened.[119] We think it is both necessary and fair to adhere to that rule here.

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[116] Transwestern's motion reiterates in part and expands in part on previous requests it has made to reopen the record. *See* its Brief on Exceptions at 28-29, 33-37, 49 and its Answer to Motion to Expedite, filed on April 5, 1985.

[117] 18 C.F.R. § 385.716 (1984).

[118] Some of the changes Transwestern points to add only detail to the record. For example, Transwestern points out that El Paso's minimum bill will be 60 percent as of July 1, 1985. Transwestern argues that the record needs to be supplemented on this point because El Paso's minimum bill will affect Transwestern's ability to compete in the southern California market. But during the hearing the parties discussed extensively the problems that would arise if one of the interstate pipelines in the southern California market had a minimum bill higher than the other. We have considered the whole question and have found that it does not justify the retention of the Transwestern minimum bills. *See* supra pp. 39-44.

Other changes Transwestern points to are new. But they are not significant. For example, Transwestern points out that Order No. 380, *et seq.* was issued after the close of the record. Transwestern argues that the record needs to be supplemented by evidence on the effect of the Order No. 380 *et seq.* As we have explained above, however, this evidence is irrelevant. *See supra* note 57.

[119] *See ICC* v. *Jersey City*, 322 U.S. 503, 514-15 (1984); *Air Products & Chemicals, Inc.* v. *FERC*, 650 F.2d 687 (5th Cir. 1981).

First, several of the changes Transwestern contends should be reflected in the record are themselves subject to change. For example, Transwestern makes much of the December 28, 1984, decision of the CPUC concerning sequencing. But we are also told that the CPUC is contemplating changes in that decision in the "near future."[120] Hence, if we were to reopen the record to reflect the CPUC's sequencing decision, there is every reason to believe that the supplemented record would be out of date by the time we had a chance to consider it. Hence to reopen the record to take account of the CPUC's sequencing decision creates the possibility that our decision will be considerably delayed.[121] That cannot be permitted.

Second, by this point any delay in the decision of this case is intolerable. Minimum bills affect the purchasing decisions of the pipelines' customers. This has certainly been true of Pacific. To enable it to conduct its business in an efficient manner the question of Pacific's minimum bill obligations should be resolved as quickly as possible.[122]

Third, the reason there is such a large gap between the close of the record and now is because we consolidated this proceeding with another proceeding.[123] We did that at Transwestern's request.[124] Hence the staleness of the record is

[120] Answer of Transwestern to Motion to Expedite, at note 1.

[121] The CPUC's sequencing decision is not the only change Transwestern wants reflected in the record that could considerably delay our decision. Evidence on El Paso's minimum bill could have the same effect. El Paso's 60 percent minimum bill is being considered in the hearing in Docket No. RP85-58. Our decision might change the mimimum bill. Should we do so we would have to reopen the supplemented record made concerning the effect of El Paso's 60 percent minimum bill.

[122] *See* Pacific's Motion to Expedite, filed on March 21, 1985; *see also Pacific Gas Transmission Co.*, 28 FERC at 61,404.

[123] As we have noted previously, the net effect of the consolidation was to delay any progress in this proceeding by about one year. *Pacific Gas Transmission Co.*, 28 FERC at 61,404.

[124] *Pacific Gas Transmission Co.*, 26 FERC ¶61,111 (1984).

largely of Transwestern's own making. Though we do not fault Transwestern for seeking consolidation, we do think it must live with the consequences of its own actions.

Finally, to decide this case now in no way precludes Transwestern from bringing to our attention in another case the changed circumstances it relies on in its motion. Generally, our decisions in rate cases do not have any *res judicata* effect.[125] That is true with respect to our decision here. All we have held is that based on this record Transwestern's minimum bills are unlawful and that no evidence has been provided to justify any minimum bill. Thus, if Transwestern thinks the changes since the record closed justify minimum bills for its customers, it is free to file rate schedules that include a minimum bill and argue that changed circumstances warrant approval of the minimum bills.[126]

**The Commission orders:**

(A) The initial decision is affirmed to the extent it is not inconsistent with this order.

(B) Within 30 days from the issuance of the opinion and order Transwestern shall file revised rate schedules in compliance with the terms of this opinion and order.

(C) The joint motions of Transwestern and Northwest Central to withdraw settlements certified on October 4, 1984, are granted.

(D) The settlement between Transwestern and Northwest Central filed on May 6, 1985, is approved.

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[125] *Comm'r* v. *Sunnen,* 333 U.S. 591, 601-602 (1948); *Louisiana Power & Light Co.,* Opinion No. 110, 14 FERC ¶61,075, at 61,137 n. 86, *reh'g denied,* Opinion No. 110-A, 15 FERC ¶61,297 (1981), *aff'd mem. sub nom. Cities of Winnfield* v. *FERC,* 683 F. 2d 415 (5th Cir. 1982).

[126] We of course intimate no view on the reasonableness of such a filing.

(E) The settlement filed on May 9, 1985, is approved subject to the terms of this opinion and order.

(F) The Twenty-Ninth Revised Sheet No. 5 and the Original Sheet No. 35 to the Second Revised Volume No. 1 of Transwestern's FERC Gas Tariff are accepted for filing to become effective on July 1, 1985.

(G) Transwestern's motion for oral argument is denied.

(H) Transwestern's motion to file a Supplemental Brief Opposing Exceptions is granted to the extent that the first two pages of the Supplemental Brief may be filed.

(I) Transwestern's motion to reopen the record is denied.

(J) Exceptions not granted are denied.

By the Commission.

(SEAL)

Lois D. Cashell,
Acting Secretary.

# APPENDIX D

## UNITED STATES OF AMERICA
## FEDERAL ENERGY REGULATORY COMMISSION

**PIPELINE RATES: BURDEN OF PROOF, MINIMUM BILLS, UNDUE DISCRIMINATION**

**Before Commissioners:** Anthony G. Sousa, Acting Chairman; Charles G. Stalon and C. M. Naeve.

**Transwestern Pipeline Company** Docket Nos. RP81-130-024 through RP81-130-026

## OPINION NO. 238-A

## OPINION AND ORDER DENYING REHEARING
**(Issued August 4, 1986)**

### I.

Transwestern Pipeline Company (Transwestern), El Paso Natural Gas Company (El Paso), and a group of El Paso's customers, known as the EOC Companies, seek rehearing of Opinion No. 238.[1] In that Opinion we held that Transwestern's minimum bills were unjust, unreasonable, unduly discriminatory, and preferential and hence should be eliminated. We find nothing in the arguments of Transwestern, El Paso, or the EOC Companies that warrants a change in that conclusion. Accordingly, we shall deny rehearing. There are, however, several arguments that require discussion.

### II.

Transwestern has two partial requirements customers — Pacific Lighting Gas Supply (Pacific) and Northwest Central

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[1] 32 FERC ¶ 61,009 (1985).

Pipeline Corporation (Northwest Central). The rate schedules for both customers have for some time included minimum commodity bills, which require the customers to take a certain amount of gas or pay the minimum commodity bill. But the minimum commodity bills applicable to the two customers are different. Pacific must take or pay for 91 percent of its annual contract quantity. Northwest Central, however, must take or pay for only about 59 percent. A number of parties and our trial staff argued that this difference is unduly discriminatory and preferential.

In addressing this argument in Opinion No. 238 we first held that Transwestern bore the burden of proof. We based this holding on the facts that Transwestern had started this case by filing increased rates pursuant to section 4 of the Natural Gas Act and that the minimum bills were integral to the manner in which the increased rates are charged.[2] In its application for rehearing Transwestern argues that in so holding we erred. We agree. Transwestern proposed no change in its minimum bills. The burden of proof was therefore on the persons challenging the minimum bills. *ANR Pipeline Co.* v. *F.E.R.C.*, 771 F. 2d 507 (D.C. Cir. 1985).

But this error was harmless. In Opinion No. 238 we assumed the intervenors and the trial staff had the burden of proof, assessed the evidence accordingly, and concluded that they had met their burden.[3]

Transwestern contends, however, that we in fact did not assess the evidence on the assumption that the intervenors and the staff bore the burden of proof. To support this

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[2] Opinion No. 238, 32 FERC at p. 61,028.

[3] *Id.* ("Even if the burden [of proof] were on the intervenors and the staff to show that the minimum bills are unlawful, that burden has been met. The record shows beyond any serious doubt that, as the judge concluded, Transwestern's minimum bill provisions unduly discriminate against Pacific and unduly favor Northwest Central.")

contention, Transwestern points out that in concluding our discussion of the discrimination issue in Opinion No. 238 we said:

> Finding then that the differences between Transwestern's minimum bills applicable to Pacific and Northwest Central have not been justified, we affirm the judge and hold that Transwestern's minimum bills are unduly discriminatory.[4]

Transwestern argues that by saying "the differences . . . have not been justified . . ." we imposed the burden of proof on it. We disagree. The argument confuses the burden of proof in the sense of the burden of persuasion, which is the meaning the phrase has in *ANR Pipeline Co.* v. *F.E.R.C.*, with the burden of proof in the sense of the burden of producing evidence.

Undue discrimination is in essence an unjustified difference in treatment of similarly situated customers.[5] The complainant alleging that existing rate schedules unduly discriminate against a customer bears the burden of persuading us that the rate schedules do so. And the complainant must always do so; the burden of persuasion never shifts. The complainant also bears the initial burden of producing evidence to substantiate its allegation. The complainant satisfies this burden by coming forward with evidence showing that the customers are similarly situated and that they are being treated differently. Once the complainant does so, the

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[4] *Id.* at p. 61,029.

[5] *See, e.g., Leigh Portland Cement Co.* v. *Florida Gas Transmission Co.*, Opinion No. 807, 58 FPC 2795, 2802, *reh'g denied*, Opinion No. 807-A, 59 FPC 2156 (1977), *aff'd sub nom., Sebring Utilities Comm'n* v. *F.E.R.C.*, 591 F.2d 1003 (5th Cir.), *cert. denied*, 444 U.S. 879 (1979); *St. Michaels Utilities Comm'n* v. *F.P.C.*, 377 F.2d 912, 915 (4th Cir. 1967); *quoting United States* v. *Chicago Heights Trucking Co.*, 310 U.S. 344, 351 (1940).

burden of producing evidence shifts to the pipeline "to justify [the] disparity on the basis of factual differences."[6]

In this case the intervenors and the staff met their burden of producing evidence by showing that Pacific and Northwest Central are similarly situated and that the minimum bills applicable to each are different. Hence it was incumbent on Transwestern to produce evidence "to justify [the] disparity . . ." But it did not. Our statement in Opinion No. 238 that the difference between the minimum bills applicable to Pacific and Northwest Central had not been justified simply recognized this fact. Thus, we did not impose on Transwestern the burden of persuasion.

Transwestern also disagrees with our findings that Pacific and Northwest Central are similarly situated customers and that the difference in the treatment of these two customers has not been justified. With respect to the finding that Pacific and Northwest Central are similarly situated customers, Transwestern makes two points. First, Transwestern points out that this finding is based on the facts that:

> Both receive firm service from Transwestern. Both also buy gas from producers and other pipelines, some of which sell gas at a lower price than Transwestern does. And both now have more gas available from their suppliers than they need to meet demand.[7]

Transwestern argues that these facts are insufficient to show that Pacific and Northwest Central are similarly situated. Transwestern cites as support two cases: *Michigan Consolidated Gas Co.* v. *F.P.C.*, 203 F.2d 895, 901 (3rd Cir. 1953)

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[6] *City of Frankfort* v. *F.E.R.C.*, 678 F.2d 699, 705 (7th Cir. 1983), *quoting, Publ. Serv. Co. of Indiana* v. F.E.R.C., 575 F.2d 1204, 1212 (7th Cir. 1978); *see also, Publ. Serv. Co. of Indiana*, 8 FERC ¶ 61,223, at p. 61,731 (1979); *Boston Edison Co.*, 8 FERC ¶ 61,217 at p. 61,725 (1979).

[7] Opinion No. 238, 32 FERC at p. 61,029.

and *Carolina Pipeline Co.* v. *Southern Natural Gas Co.*, 31 FPC 705, 707 (1964). We disagree.

First, the two cases Transwestern relies on are not to the contrary. Neither case established general principles or standards for determining when customers are similarly situated. Each case stands simply for the proposition that on the facts shown the customers were dissimilar.

Second, the facts cited in Opinion No. 238 are more than enough to show that Pacific and Northwest Central are similarly situated customers. Indeed, as the judge concluded, these facts "clearly" show the two customers to be similarly situated.[8] But these facts were rather baldly stated in Opinion No. 238. Therefore, since the question of the adequacy of these facts has been raised, we will explain why they show Pacific and Northwest Central to be similarly situated.

Transwestern's arguments, however, require us to make a preliminary point. The inquiry into the question of whether the two customers are similarly situated is not simply a search for any facts that show the customers to be similar or dissimilar. The inquiry is more structured than that. This structure is provided by two standards. First, because we regulate pipelines on a cost-of-service rather than on a value-of-service basis, the inquiry must focus on "the impact the provision of utility services to specific customers has on the supplying utility."[9] Second, the inquiry must focus on facts that are relevant to the difference in treatment at issue.

In light of these standards the first task is to define with particularity the difference in treatment. By virtue of our

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[8] 29 FERC ¶ 63,054 at p. 65,160 (1984).

[9] Pierce, Allison, and Martin, Economic Regulation: Energy, Transportation and Utilities 300 (1980).

minimum bill rule,[10] Transwestern's minimum bills are restricted to recovering fixed costs included in the commodity charge. As such, they act like additional demand charges in that they guarantee the recovery of fixed costs. Consequently, the effect of the difference in the minimum bills is to guarantee that Transwestern will recover a far larger percentage of its fixed commodity costs from Pacific than from Northwest Central. The second task before us is therefore to determine whether there are any differences between Pacific and Northwest Central that affect Transwestern in such a way that it should be assured of recovering a larger percentage of its fixed commodity costs from one customer than the other. To do so, three specific questions must be asked.

The first question is whether there are any differences in the service Transwestern provides the two customers. There are no such differences. Transwestern's certificate and contractual obligation to Pacific and Northwest Central are in all material respects the same. Transwestern is obliged to stand ready to sell gas to each every day of the year. The maximum amount Transwestern must sell to each is specified and does not vary over the course of the year. In short, Transwestern provides firm service to both.

The second question is whether there are any differences in the way the rates for the two customers are developed and paid that would warrant Transwestern recovering a larger

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[10] Elimination of Variable Costs from Certain Natural Gas Pipeline Commodity Bill Provisions, Order No. 380, *FERC Statutes and Regulations, Regulations Preambles 1982-1985* ¶ 30,571; Order No. 380-A, *FERC Statutes and Regulations, Regulations Preambles 1982-1985* ¶ 30,584; Order No. 380-B, 29 FERC ¶ 61,076; Order No. 380-C, *FERC Statutes and Regulations, Regulations Preambles 1982-1985* ¶ 30,606; Order No. 380-D, 29 FERC 61,332 (1984), *aff'd in relevant part sub nom., Wisconsin Gas Co.* v. *F.E.R.C.*, 770 F.2d 1144 (D.C. Cir. 1985), *cert. denied.* — U.S. — (May 9, 1986) [hereinafter cited as Order No. 380, Order No. 380-A, *etc.*, as appropriate].

percentage of its fixed commodity costs from Pacific than from Northwest Central. There are no such differences. The cost classification and rate design method used to establish the rates for both is the same.[11]

Under this method some of the fixed costs Transwestern incurs in providing service to each customer are classified to the demand component and recovered through the demand charge. The remaining fixed costs are classified to the commodity component and recovered through the commodity component.[12]

Because of the way the demand charge is designed, Transwestern is guaranteed recovery of the fixed costs classified to the demand component. So there is no difference in the amount of fixed demand costs Transwestern will recover from Pacific and Northwest Central.

But there can be a difference in the amount of fixed commodity costs Transwestern may recover from each. This is so because the stated commodity charge is determined by dividing each customer's expected purchases into the commodity costs allocated to each. The commodity revenues each customer pays, however, is determined by multiplying the commodity charge by the customer's actual purchases. If one of the customers can avoid purchasing gas from Transwestern at the level used to design the rates and does so,

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[11] *See* Opinion No. 238, 32 FERC at pp. 61,024-25. Traditionally, the method of cost classification and rate design used to establish rates for Pacific and Northwest Central has been the *Seaboard* method, *Id.* at p. 61,039, n. 18. In Opinion No. 238 we held that the *Seaboard* method was unjust and unreasonable and that Transwestern should use the modified fixed-variable method of cost classification and rate design. *Id.* at pp. 61,034-45. This change, however, does not affect the point at issue here, for the modified fixed-variable method will be used to develop the rates for both Pacific and Northwest Central.

[12] *Id.* at pp. 61,024-25. We were there describing the *Seaboard* method. But the modified fixed-variable method is in this respect the same.

Transwestern will not recover all the fixed commodity costs allocated to the customer. A minimum bill is intended to assure that Transwestern recovers a portion of those costs by requiring the customer to pay a portion of the commodity charge whether or not it buys any gas. Hence, where there is a difference in minimum bills, a relevant question to ask is whether the customers differ in their ability to buy less gas than expected. For example, it is not unduly discriminatory for a pipeline to impose a minimum bill on its partial requirement customers but not on its full requirement customers. The customers are different in that the partial requirement customers can control their purchases while the full requirement customers cannot.[13]

But again, there is no such difference in this case. Both Pacific and Northwest Central have the ability to control their purchases. Both have suppliers besides Transwestern.[14] And both have more supplies available to them than they need to meet demand.[15] More important both have an incentive to control their purchases from Transwestern. For both, Transwestern is a relatively high cost supplier.[16] And both are losing load to lower cost alternative fuels.[17]

Transwestern's second point is that there are many differences between Pacific and Northwest Central that we have not considered. These differences undoubtedly exist. But at

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[13] *Mississippi River Transmission Corp.* v. *F.E.R.C.*, 759 F.2d 945, 957 (D.C. Cir. 1985).

[14] *See* Opinion No. 238, 32 FERC at pp. 61,025-26, p. 61,039 nn. 24 and 25, and p. 61,040 n. 29.

[15] *Id.* at pp. 61,025-26 and p. 61,039 n. 23.

[16] *Id.* at p. 61,026 and p. 61,040 n. 29.

[17] *Id.* at p. 61,026 and p. 61,039 nn. 27, 29.

most these differences show that Pacific and Northwest Central are not identical.[18] We need not, however, find customers to be identical before requiring the pipeline to justify a disparity in treatment. It is enough if the record shows that

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[18] The reasons this is so need only brief mention. First, Transwestern argues that Pacific and Northwest Central are different in that: (1) Pacific's market is assured while Northwest Central's is not; (2) Pacific's profitability is not affected by the price of gas while Northwest Central's is; and (3) Pacific need not make any sales for its parent to earn its return while Northwest Central must. The problem with this argument is that, as Transwestern itself has recognized, Brief on Exception for Transwestern, at 5, "Pacific merely acts as a conduit, reselling all its gas to its distribution affiliate, Southern California Gas Company (SoCal)." Thus, the real party affected by Transwestern's minimum bill is SoCal. SoCal is like Northwest Central. Its market is not assured. Its ability to sell gas is affected by price. And it must sell gas for it and its parent to earn a profit. (The profitability of Pacific is, of course, irrelevant. Any profit it makes is based on the payments it receives from its affiliate, SoCal. But in determining the profitability of a consolidated entity intracorporate payments are ignored. Profitability is instead based on payments received from outsiders. In the case here that means the payments SoCal receives from consumers for gas.)

Second, Transwestern argues that Pacific and Northwest Central are different because: (1) Northwest Central has large volumes of low-cost gas supplies in the Hugoton from which it can draw while Pacific does not; and (2) Northwest Central is committed to buying high-cost gas from producers while Pacific is not. But the record shows that, while Pacific does not have low-cost supplies in the Hugoton, it has historically been able to buy gas from El Paso at a price lower than Transwestern's. *See* Opinion No. 238, 32 FERC at p. 61,026; Exh. 55, p. 14. The record also shows that, while Pacific is not committed to buying high-cost gas from producers, SoCal, through its affiliate, Pacific Interstate Transmission Company, is committed to purchasing high-cost gas from Canadian producers. *See* Exh. 51, p. 5; Exh. 55, p. 14. (Transwestern also points out that Northwest Central is bound by Commission order to a high load factor use of its Rawlins-Hesston line, *see Cities Service Gas Co.*, 23 FERC ¶ 61,193 (1983), while Pacific is not. Since the Rawlins-Hesston line is used solely to transport the gas from Northwest Central's high-cost producers, we do not think this difference adds anything to the argument.)

the customers are similarly situated.[19] The differences Transwestern points to do not detract from the similarity between

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Third, Transwestern argues that Northwest Central and Pacific are different in that Pacific is subject to the California Public Utilities Commission's purchasing policy, in which the price of gas is a key factor, while we have imposed no similar purchasing policy on Northwest Central. The problem with this argument is that pipelines subject to our jurisdiction are not free to buy gas without regard to cost. Pipelines have a duty to provide service at the lowest reasonable cost. *Atlantic Refining Co.* v. *Public Service Comm'n,* 360 U.S. 378, 389 (1959); *see also, Columbia Gas Transmission Corp.,* Opinion No. 204, 26 FERC ¶ 61,034 at p. 61,100, *clarified,* Opinion No. 204-A, 26 FERC ¶ 61,334 (1984), *rev'd on other grounds sub nom. Office of Consumer Counsel* v. *F.E.R.C.,* No. 84-1099 (D.C. Cir. Feb. 4, 1986). Northwest Central has endeavored to satisfy this duty by following a net back target price purchasing policy. *See* Exh. 67, p. 7. (The question of whether Northwest Central's purchasing policy is consistent with its duty to provide service at the lowest reasonable cost is a question that is now before us in *Northwest Central Pipeline Corp.,* Docket No. TA84-2-43-001, *et al.* We, of course, intimate no views on the merits of that question here.)

[19] If this were not so, it is hard to see what significance there would be to the Natural Gas Act's prohibition of undue discrimination, for the statute prohibits pipelines from "maintaining any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service." But localities will always differ to some extent. And classes of service are by definition dissimilar in some respects. It is because customers are in some respects different that they are grouped in different classes. Yet these facts have not stopped the Commission from finding undue discrimination as between localities or as between classes of service. *See e.g., Central Illinois Publ. Serv. Co.,* Opinion No. 142, 20 FERC ¶ 61,043, *reh'g denied,* Opinion No. 142-A, 20 FERC ¶ 61,435 (1982), *aff'd sub nom., Cities of Bethany* v. *F.E.R.C.,* 727 F.2d 1131, *cert. denied,* 105 S. Ct. 293 (1984). (In this case the Commission first held that the utility properly classified its wholesale customers into two groups and then held that a difference in rates between the two groups was not unduly discriminatory. The Commission based the first holding on the fact that the customers were dissimilar. But the Commission did not base its second holding on this fact. Instead,

Pacific and Northwest Central the record shows to exist.[20]

With respect to our finding that the difference in the minimum bills has not been justified, Transwestern argues that the difference is justified. It points out that the difference in the minimum bills is the result of different contractual provisions. This difference is that Transwestern's contracts with Northwest Central contain a downward ratchet provision while its contract with Pacific does not. Under the downward ratchet provision the quantities used in calculating Northwest Central's minimum bills are reduced permanently when Transwestern is unable, as it was during the 1970's to deliver the contract demand quantities. The quantities used to calculate Pacific's minimum bill are not similarly reduced even though Transwestern also had to curtail deliveries to Pacific during the 1970's. Transwestern contends that this difference in contractual provisions justifies the difference in the minimum bills. Transwestern cites *Cities of Bethany* v. *F.E.R.C.*, 727 F.2d 1131 (D.C. Cir. 1983), *cert. denied*, 105 S. Ct. 293 (1984), for support.[21] We disagree.

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the Commission held that the difference was not unduly discriminatory because the difference was justified by other factors. *See infra* pp. 11-12.)

[20] Even if we were to credit these differences with some significance, we still could not agree with Transwestern. The differences would suggest that Northwest Central is more likely than Pacific to control its purchases from Transwestern and that Transwestern is less likely to recover its costs from Northwest Central than from Pacific. Yet because of the differences in the existing minimum bills, Transwestern has less assurance of recovering its fixed costs from Northwest Central than from Pacific.

[21] Transwestern also cites in support *Consolidated Edison Co.* v. *F.E.R.C.*, 676 F.2d 763, 773 (D.C. Cir. 1982), and *City of Lakeland* v. *F.E.R.C.*, 702 F.2d 1302, 1309 (11th Cir. 1983). Both cases are inapposite; neither involved the question presented here. The Consolidated Edison case involved a question arising under an end-use curtailment plan. Under an end-

To be sure, differences in contractual provisions are relevant to the question of whether a difference in treatment is

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use curtailment plan some customers are curtailed more than others even though their contracts are similar. One customer argued that, because it is unduly discriminatory to treat customers with similar contracts differently, the customers that were curtailed less should compensate those that were curtailed more. The Commission disagreed, and the court affirmed. The court did so on the ground that the similarity in contracts was not decisive on the question of whether compensation was due. More important in the court's view was the fact that the end-use profiles of the customers differed and that this fact was a relevant consideration. Thus, this case actually supports the opposite of Transwestern's position.

The *Cities of Lakeland* case is even farther afield. Transwestern quotes the court as follows: "[T]he competitive impact . . . originates from different supply arrangements . . . [W]e are not confronted by circumstances in which similarly-situated customers are being treated differently." This quote seems to imply that the court held that the pipeline could have different contractual arrangements with its customers and that this fact means the difference in treatment is not unduly discriminatory. The court, however, implied nothing of the kind. Transwestern has left five words off the court's statement that totally change its meaning. The facts of the case are these: Petitioners were several municipal electric utilities that purchased gas from the pipeline. They were accorded a low priority under the pipeline's end-use curtailment plan. They argued that this was discriminatory because they had to compete against electric utilities that had bought gas directly from producers and were therefore unaffected by the pipeline's curtailment. The Commission rejected this claim because the competitive impact of the curtailment plan petitioners complained of did not stem from the curtailment plan. It stemmed from the fact that petitioners bought gas from the pipeline while their competitors did not. (These were the "different supply arrangements" mentioned in the statement Transwestern quotes.) The court affirmed by quoting the Commission's Opinion, which, as stated by the court and without Transwestern's deletions, was:

> What [petitioners] apparently do not recognize is that the competitive impact which they describe stems not from the curtailment plan. It originates from different supply arrangements that arose previously and without reference to the curtailment plan. Thus, unlike cases involving price squeeze, we are not confronted by circumstances in which similarly-

justified.[22] But the mere "execution of different contracts [is] not, in itself, sufficient to justify rate disparities in light of the proscription against undue discrimination" in section 4(b).[23] A brief examination of the *Cities of Bethany* case shows why.

In that case the utility offered to settle a rate case with its wholesale customers. One group of customers accepted the settlement. Another group did not. They chose to litigate. The result of the litigation was that the rates for the customers that chose to litigate were higher than the rates for the customers that chose to settle.

The customers that chose to litigate did not care for this result. So they argued that the rate disparity was unduly discriminatory. The Commission rejected this argument. It found the difference justified. The Commission did not, however, simply point out that the group that settled had, in effect, contracted for a fixed rate while the group that chose to litigate did not. Instead, the Commission pointed out that the difference was justified because the record showed that: (1) the utility had offered rates to both groups of customers based on the same methodology; (2) the difference in rates was likely to be temporary; and (3) the customers that chose

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situated customers are being treated differently *by the entity we regulate.* (Emphasis added.)

[22] *See e.g., Town of Norwood* v. *F.E.R.C.,* 587 F.2d 1306 (D.C. Cir. 1978), *Borough of Chambersburg* v. *F.E.R.C.,* 580 F.2d 573 (D.C. Cir. 1978); *Publ. Serv. Co. of Indiana* v. *F.E.R.C. 575 F.2d 1202 (7th Cir. 1978).*

[23] *Cities of Frankfort* v. *F.E.R.C.,* 678 F.2d at 702 *citing Publ. Serv. Co. of Indiana* v. *F.E.R.C.,* 575 F.2d 1202 (7th Cir. 1978).

to litigate were not injured as a result of the difference.[24] The court affirmed for the reasons given by the Commission.[25]

The difference between the *Cities of Bethany* case and this case is immediately apparent. First, the record does not show — nor is there even an allegation — that Transwestern offered Pacific the same downward ratchet it offered to Northwest Central. Second, the difference has been and will continue to be a long term difference.[26] And third, the difference has harmed Pacific.

The reasons we found that the difference in minimum bill provisions had harmed Pacific were set forth in footnote 52 to Opinion No. 238.[27]

We made two points there. First, we noted that, because in 1982 Transwestern did not have sufficient firm supplies to meet its maximum contractual obligations to both its customers, the difference in the minimum bills enabled Northwest Central to refuse deliveries of firm gas, thereby enabling Transwestern to force Pacific to take firm gas at a price above other firm supplies available to it. This reduced Pacific's ability to buy cheaper gas from El Paso. Second, we noted that Transwestern had bought interruptible gas to

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[24] *Central Illinois Pub. Serv. Co.,* Opinion No. 142, 20 FERC ¶ 61,043, *reh'g denied.* Opinion No. 142-A, 20 FERC ¶ 61,435 (1982).

[25] For another decision that reaches the same conclusion on essentially similar facts, *see Cities of Newark* v. *F.E.R.C.,* 763 F.2d 533 (3rd Cir. 1985).

[26] The difference started in 1967 and will continue under the CDQ-2 contract until it is terminated on May 31, 1986, *see* Article V, section 5, of the settlement submitted by Transwestern on May 9, 1985, in these dockets, and under the CDQ-3 contract until it is terminated in 1991. (We note that in Docket No. CP86-276, Transwestern has applied to abandon service under the CDQ-2 contract, effective February 1, 1986. We have not yet acted on the application.)

[27] 32 FERC at p. 61,041.

meet its maximum contractual commitments to both customers. Because of the difference in minimum bills, Northwest Central did not have to take any of this gas. But Pacific did. Since the price of this interruptible gas was higher than Transwestern's system average gas costs, the result of the difference in minimum bills was that Pacific had to reduce its purchases of lower priced gas so that it could take higher priced gas that Transwestern itself did not have to take.

In its application for rehearing, Transwestern does not dispute the first point. But it does dispute the second. It makes four arguments. First, Transwestern argues that because it did not have to agree to take or pay for the interruptible gas, its purchase of the interruptible gas was a benefit to Pacific. But Pacific did not need this gas at all. It could not sell all the firm gas available to it from its suppliers.[28] Hence we see no benefit to Pacific.

Second, Transwestern argues that its purchase of interruptible gas was proper because it did so to meet its certificate obligations. Meeting certificate obligations is important. But when it comes to buying high-cost interruptible gas to meet those obligations we do not think pipelines can ignore the fact that their customers do not need the gas.[29]

Third, Transwestern argues that in Phase I of this case we approved the purchase of interruptible gas. This is correct. But this does not contradict the point we made in Opinion No. 238 concerning Transwestern's practice of purchasing interruptible gas. All that the Commission did in Phase I was to affirm the judge's very narrow holding that Transwestern's purchase of interruptible gas was reasonable so long as Transwestern's minimum bills existed. As the judge made

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[28] *Id.* at pp. 61,025-026.

[29] *See Columbia Gas Transmission Co.*, Opinion No. 204, 26 FERC at p. 61,101.

clear, that holding did not reach the question presented here, namely "[w]hether or not the existing minimum bill provisions in Transwestern's tariff give rise to gas acquisition practices that result in increasing the unit cost of purchased gas for the pipeline system. . . ." That question, as the judge noted, was to be addressed in this phase of the case.[30]

Fourth, Transwestern says that in note 52 we said that Pacific "purchased" 733 MMcf per day from Transwestern, which was well above Pacific's minimum bill obligation of 682.5 MMcf. Consequently, Transwestern argues, interruptible gas purchases cannot be said to have forced Pacific to purchase at minimum bill levels. Instead, Transwestern opines, Pacific bought the gas because it needed it. The problem with this argument is that we never said that Pacific "purchased" 733 MMcf per day. What we said was that Transwestern "delivered" 733 MMcf per day. That amount is not the same as the amount Pacific purchased. Pacific's operating records for 1982 show that Pacific refused delivery of about 80 MMcf per day. Hence what Pacific purchased was about 653 MMcf per day. The reason we noted the amount Transwestern delivered rather than the amount Pacific purchased was because under Transwestern's minimum bill with Pacific, Transwestern must deliver at least 91 percent of the Annual Contract Quantity of 273,500 MMcf (which equals 682.5 MMcf per day) for Pacific's minimum bill obligation to be fully in force. If Transwestern is unable to deliver this amount, then Pacific must take or pay for 100 percent of the amount Transwestern actually delivers.[31] That Transwestern was able to deliver an average 733 MMcf per day shows that its minimum bill with Pacific was fully in

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[30] *Transwestern Pipeline Co.*, 26 FERC ¶ 63,008, at p. 65,019, *aff'd*, 27 FERC ¶ 61,255, *reh'g denied*, 28 FERC ¶ 61,209 (1984)

[31] *See* Opinion No. 238, 32 FERC at p. 61,025.

force. Since Transwestern did not have enough firm supplies available to be able to deliver on average 682.5 MMcf per day to Pacific, it was the purchase of interruptible gas that enabled Transwestern to keep its minimum bill fully in force and thereby require Pacific to take or pay for at least 682.5 MMcf per day.

In a rather strained argument Transwestern contends that the downward ratchet provisions in its contracts with Northwest Central justify the difference in the minimum bills for another reason. During the course of the hearing there was a dispute between the trial staff, on the one hand, and Transwestern and Northwest Central, on the other, over the reduction in the minimum bills the ratchet provisions permit. In Opinion No. 238,[32] we noted that this dispute had been resolved after the hearing when, in his first initial decision[33] the judge had ordered Transwestern to file a contract between it and Northwest Central interpreting the ratchet provisions as providing for, in effect, a 59 percent minimum bill.[34] We noted that, since we had accepted the contract for filing, the contract was controlling on the question of just what Northwest Central's minimum bill obligation was. In its application for rehearing Transwestern argues that, because we accepted the contract for filing, the difference in minimum bills cannot be unduly discriminatory. This is so, Transwestern argues, because the Commission cannot accept the contract without first determining its reasonableness. Transwestern cites *Mobile Gas Serv. Corp.* v. *F.P.C.*, 215 F.2d 883, 892 (3rd Cir. 1954), *aff'd sub nom. United Gas Pipe Line Co.* v. *Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956), as support.

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[32] *Id.* at p. 61,039 n. 22.

[33] 26 FERC § 63,008, at pp. 65,017-18 (1984).

[34] The contract is Exh. 92.

This argument is without merit. Our acceptance of the contract for filing does not constitute approval. 18 C.F.R. § 154.23 (1985). *Mobile Gas Serv. Corp.* v. *F.P.C.* is not to the contrary. That case stands simply for the proposition that the "contract between the parties governs the legality of the filing. Rate filings consistent with contractual obligations are valid; rate filings inconsistent with contractual obligations are invalid." *Richmond Power & Light* v. *F.P.C.*, 481 F.2d 490, 493 (D.C. Cir. 1973). The case does not stand for the proposition that by accepting a contract or rate schedule for filing we have determined it to be reasonable in all particulars. That is simply not the law. "The decision to accept a rate filing . . . is undeniably interlocutory. Acceptance of a filing decides nothing concerning the merits of the case . . . " *Papago Tribal Utility Authority* v. *F.E.R.C.*, 628 F.2d 235, 240 (D.C. Cir.), *cert. denied.* 449 U.S. 1061 (1980).[35]

In its application for rehearing, Transwestern renews an argument it made in its Brief on Exceptions. There, Transwestern argued that the judge had erred in finding the minimum bill provisions unduly discriminated against Pacific because all of Transwestern's "supply arrangements were filed with, reviewed and approved by the Commission" in certificate proceedings.[36] In Opinion No. 238 we rejected this argument because the "question of whether Transwestern's minimum bill provisions unduly discriminate against Pacific does not appear to have been raised in the prior proceedings,

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[35] The only exception to this rule is where, as in the *Mobile case*, the Commission has accepted a rate increase filing after considering and rejecting the contention that a contract barred the rate increase. *ASARCO, Inc.* v. *F.E.R.C.*, 777 F.2d 764 (D.C. Cir 1985).

[36] Brief on Exceptions for Transwestern, at 31 (footnote omitted).

and we have never considered the issue before."[37] On rehearing, Transwestern argues that this was erroneous. It alleges that on two pages of the transcript in each of the two proceedings in which the Commission issued a certificate to Transwestern to serve Northwest Central the question was raised. This is incorrect. No issue concerning the discriminatory effect the minimum bill provisions with Northwest Central would have on Pacific was raised on the pages of the transcripts cited by Transwestern.[38] More important, in view of the wide latitude judges give counsel to inquire into subjects, is the fact that no party in either proceeding raised in their briefs to either the judge or the Commission any issue concerning the discriminatory effect of Transwestern's minimum bills with Northwest Central. Thus, we are left with Transwestern's original contention that we are bound for all time by everything in a certificate application that we did not specifically reject when we approved the application. "That," as we have said before, "is absurd on its face."[39]

Finally, Transwestern contends that, if its minimum bills are unduly discriminatory, we should not have eliminated the minimum bills entirely. Instead, Transwestern argues, we should only have eliminated the discrimination by either reducing Pacific's minimum bill or increasing Northwest

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[37] 32 FERC at p. 61,029.

[38] On pages 3723-24 of the transcript in Docket No. G-20464 the only issue raised was whether a reduction in Northwest Central's minimum bill by virtue of the ratchet would also reduce Transwestern's contractual obligation to deliver. This issue was also the only issue raised on pages 1017-18 of the transcript of Docket No. CP67-220, *et al.*

[39] *Northwest Pipeline Co.*, Opinion No. 213-A, 27 FERC § 61,339, at p. 61,657 (1984); *see also, Webster* v. *Fall*, 266 U.S. 507, 511 (1925) ("Questions which merely lurk in the record, neither brought to the attention of the court nor ruled upon, are not to be considered as having been so decided as to constitute precedents.").

Central's. This argument might have merit if we had only found that the minimum bills were unduly discriminatory. But we did not. We also found that any minimum bill for either Northwest Central or Pacific was unjust and unreasonable. It is to Transwestern's arguments concerning this finding that we now turn.

## III.

In Opinion No. 238 we held that Transwestern's minimum bills were unjust and unreasonable because they unreasonably restrained trade. Transwestern disputes this finding. It makes a number of arguments.

First, Transwestern contends that in finding its minimum bills to be unreasonable restraints of trade we simply and simplistically assumed that, because the minimum bills are parts of contracts, they restrain trade and foreclose competition. Citing Justice Brandeis's famous statement in *Chicago Board of Trade* v. *United States,* 246 U.S. 231, 238 (1918), that "every agreement concerning trade . . . restrains. To bind, to restrain, is of their very essence." Transwestern argues that this assumption is insufficient to support our finding that its minimum bills unreasonably restrain trade.

This argument would be devastating if we made the assumption Transwestern says we did. But we did not.

In Opinion No. 238, after noting that the effect of a minimum bill is to restrain trade, we said that *"[i]n certain situations this restraint may,* if there is inadequate justification for it, amount to an unreasonable and therefore unlawful restraint of trade,"[40] The situations where the restraint does amount to an unlawful restraint are, we noted, to be determined not by application of a *per se* rule but rather by application of the rule of reason articulated by Justice

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[40] 32 FERC at p. 61,034 (emphasis added).

Brandeis in the *Chicago Board of Trade* case.[41] As refined by the courts over the years and modified by us to take into account policies arising under our statutes, the rule of reason provides that a contract is an unreasonable restraint of trade only if it is more restrictive than is necessary to meet an objective meriting recognition under the antitrust laws or the statutes we administer.[42] What this means in concrete terms is that before we may find a contract term to be an unreasonable restraint of trade we must carefully balance the competitive harm the term causes against the term's objectives in light of the alternatives available for achieving those objectives.[43] Only if on balance the term causes more harm than is warranted in light of the term's objectives and the available alternatives, can we find the term to be an unreasonable restraint of trade. It was only after finding that on balance Transwestern's minimum bills caused more harm than was warranted that we concluded that the minimum bills unreasonably restrained trade and hence were unjust and unreasonable.[44]

Next, Transwestern argues that, contrary to the holding of *ANR Pipeline Co.* v. *F.E.R.C.*, we have imposed on it the burden of proving its minimum bills just and reasonable. That we have imposed the burden on Transwestern is shown, Transwestern argues, by our statement in Opinion

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[41] 32 FERC at p. 61,042 n. 69. In this note we cited our decision in *Kentucky Utilities Co.*, Opinion No. 169, 23 FERC ¶ 61,317, at p. 61,675, *reh'g denied*, Opinion No. 169-A, 25 FERC ¶ 61,205 (1983), *rev'd on other issues*, 766 F.2d 239 (6th Cir. 1985), for the proposition that we generally employ the rule of reason analysis rather than a *per se* analysis in assessing whether a contract term unreasonably restrains trade. In that case we explicitly relied on Justice Brandeis's teaching in the *Chicago Board of Trade* case as support for that proposition.

[42] *Id.*

[43] *Kentucky Utilities Co.*, 23 FERC at p. 61,675.

[44] Opinion No. 238. 32 FERC at p. 61,034.

No. 238 that "any minimum bill recommendation for Transwestern must be justified."[45] We disagree. As with its other burden of proof argument, Transwestern has confused the burden of proof in the sense of the burden of persuasion with the burden of proof in the sense of the burden of producing evidence.[46] The burden of persuasion is on the parties challenging the minimum bills and remains there. The initial burden of producing evidence is also on these parties. They satisfy this burden by showing that the inclusion of a minimum bill in Transwestern's rate schedules will cause competitive harm. Once this is shown the burden of production shifts to Transwestern to justify retaining its minimum bills by showing that they are necessary to achieve an objective meriting recognition under the antitrust laws or the Natural Gas Act.[47] In Opinion 238 we found that the "probable consequence" of including a minimum bill in Transwestern's rate schedules would be to adversely affect competition.[48] Accordingly, it was incumbent on Transwestern to justify retaining its minimum bills. Our statement upon which Transwestern relies simply made this fact clear.

Transwestern argues that our finding that the "probable consequence" of including minimum bills in its rate schedules would be to adversely affect competition is wrong. This is so, Transwestern contends, for three reasons.

First, Transwestern notes that we began our analysis of the competitive consequences of including minimum bills in its rate schedules by analogizing its minimum bills to requirements contracts.[49] Transwestern argues that it does not have

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[45] *Id.* at p. 61,031.

[46] *See supra,* pp. 2-3.

[47] *See, City of Florence* v. *Tennessee Gas Pipeline Co.,* 25 FERC ¶ 61,314, at p. 61,714 (1983).

[48] 32 FERC at p. 61,031.

[49] Opinion No. 238, 32 FERC at p. 61,042 nn. 69 and 70.

requirements contracts with its customers. It cites Williston's treatise on contract law for support.[50]

We see no merit to this argument. The technicalities of consideration, which is the subject discussed in the section of Williston's treatise Transwestern relies on, are not relevant here. What is relevant is the economic substance. And that supports the analogy. In the antitrust literature a requirements contract is a variation of an exclusive dealing agreement. Such an agreement includes a restriction on a customer that prohibits the customer from purchasing some category of products from any other supplier.[51] Necessarily, it forecloses other suppliers from selling those products to the customer.[52] This is just what Transwestern's minimum bills do, for a customer is not likely to buy gas from another supplier if it also has to pay Transwestern for gas.[53] And this is what Transwestern's minimum bills are intended to do. As Transwestern's Senior Vice President testified, "the minimum bill is to assure that sales will continue to be made when the purchaser has available to it alternative supplies at lower costs or where it has committed to purchase gas from others."[54] Accordingly, we see nothing wrong in looking to the economic and legal literature concerning requirements

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[50] Williston, Williston on Contracts, § 104A (W. Jaeger 3rd ed. 1957).

[51] A requirements contract accomplishes the same end by binding the customer to purchase all or part of its requirements from a particular supplier. *See, e.g.*, ABA Antitrust Section, Antitrust Law Developments 95 (2nd ed. 1984); Steuer, Exclusive Dealing in Distribution, 69 Cornell L. Rev. 101, 102 n. 5.

[52] *Id.*

[53] *See Wisconsin Gas Co.* v. *F.E.R.C.*, 770 F.2d at 1157.

[54] Exh. 10, p. 12. *See also* Tr. 1585, where the same witness testified that the purpose of the minimum bills is to provide "a guaranteed level of sales. Period."

contracts for guidance in assessing the competitive impact of Transwestern's minimum bills.[55]

Transwestern's second point is that our finding is not based on record evidence. We disagree.

The record evidence shows that in 1982 Transwestern's minimum bills excluded competitors from the market and increased the price of gas to consumers.[56] There is no serious dispute about that.[57]

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[55] We are not the first to have anologized minimum bills to requirements contracts or exclusive dealing arrangements. The United States Court of Appeals for the District of Columbia Circuit has analogized minimum bills to both. *See Lynchburg Gas Co.* v. *F.P.C.*, 336 F.2d 942, 950 (1964), (Washington and Burger, JJ., concurring) (exclusive dealing), and *Atlantic Seaboard Corp.* v. *F.P.C.*, 404 F.2d 1268, 1275 (1968) (requirements contracts).

[56] 32 FERC at p. 61,026.

[57] Transwestern's only argument on this point is that because the Commission has certificated four additional suppliers to Pacific and an additional supplier to Northwest Central since its minimum bills were established, they cannot be said to have excluded competitors. We disagree. The Commission certificated the additional supplier to Northwest Central and two of the four additional suppliers to Pacific in the late 1970's and early 1980's. *Cities Service Gas Co.*, 4 FERC ¶ 61,268 (1978); *Pacific Interstate Transmission Co.*, 4 FERC ¶ 61,016 (1978); *Pacific Offshore Pipeline Co.*, 14 FERC ¶ 61,239A, *modified*, 15 FERC ¶ 61,235 (1981), *modified*, 18 FERC § 61,070 (1982). This is significant. At the time these projects were proposed Transwestern and its customers' other traditional suppliers were in severe curtailment. They could not satisfy the customers' demand. *See* Opinion No. 238, 32 FERC at p. 61,039 n. 21. In such a situation a minimum bill will not have an exclusionary effect, for there exists demand that a new competitor can supply. Thus, certification of these additional suppliers proves nothing about the effect Transwestern's minimum bills have in markets where, as in the markets served by Transwestern in 1982, supply exceeds demand. *Id.*, at p. 61,025.

The two other suppliers for Pacific or SoCal Transwestern mentions were certificated after curtailment ended and after supply began to exceed demand in the southern California market. *Pacific Interstate Offshore Co.*, 23 FERC ¶ 61,390 (1983); *Port Arguello Natural Gas Line Co.*, 31 FERC ¶ 61,257

But the minimum bills that were in effect in 1982 are based on the full commodity charge. That is, they were based not only on the fixed costs included in the commodity component but also on the variable costs, including the cost of gas. After the record closed, however, the Commission issued its minimum bill rule. That rule, of course, required minimum bills to be based solely on the fixed costs included in the commodity component. Thus, the financial consequences Transwestern's minimum bills impose on Pacific or Northwest Central for buying gas from other suppliers are now much less severe than they were in 1982. It is because of this change that Transwestern argues that there is no record evidence to support our finding that the probable consequence of Transwestern's minimum bills will be to foreclose competition or restrain trade. Simply put, Transwestern argues that, because of the change wrought by the minimum bill rule, evidence that minimum bills based on fixed and variable costs have foreclosed competition is not evidence that minimum bills based solely on fixed costs will.

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(1985). This, however, does not detract from our point. The Commission certificated the Pacific Interstate Offshore project because SoCal had represented that both of its major suppliers, El Paso and Transwestern, had forecast significant decreases in supplies over the long-term. 23 FERC at p. 61,826. And the facts that caused the Commission to certificate the Port Arguello project were so peculiar that the case proves nothing. (The pipeline was certificated to transport gas produced simultaneously from off-shore oil fields. The Commission concluded that certification was in the public interest, despite the surplus of gas in the southern California market, for two reasons. First, there were only three ways to dispose of the gas: by flaring, by re-injecting, or by transporting the gas on-shore for consumption. The first method was wasteful. So was the second because of the reservoir's characteristics. The Commission's second reason was that local authorities had required that, if a gas pipeline was to be built, it had to be built in conjunction with the oil pipeline. Hence if the gas was to be made available in the future, the pipeline had to be built now. 31 FERC at pp. 61,498-99.)

Transwestern's assessment of the impact of the minimum bill rule is largely correct. Though relevant, the fact that minimum bills based on the full commodity charge excluded competition in the past is not conclusive evidence that minimum bills based only on fixed commodity costs will. But we did not base our finding solely on the fact that Transwestern's minimum bills had foreclosed competition in 1982. We also based our finding on a predication of how fixed cost minimum bills would operate in the future in the markets served by Transwestern.[58]

The factors that support this prediction were set forth in footnote 71 to Opinion No. 238.[59] One of these was that generally accepted antitrust theory predicts that requirements contracts will not have an adverse effect on competition where the market's demand equals supply. This is so because a seller that is committed to supply the requirements of one customer has that much less supply to devote to others. Hence a competitor will be able to supply the others. But in a situation where supply exceeds demand a requirements contract will foreclose competition, for the requirements contract in effect locks up the demand that exists.[60] A second factor was that a fixed cost minimum bill would continue to compel, though presumably to a lesser extent than before, a customer to buy gas from Transwestern rather than a lower cost competitor. This would be so, we

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[58] We know of nothing that prohibits us from acting on the basis of such a finding. Indeed, the law is the other way. We may. *Wisconsin Gas Co.* v. *F.E.R.C.*, 770 F.2d at 1158, *quoting American Publ. Gas. Assoc.* v. *F.P.C.*, 567 F.2d 1016, 1037 (D.C. Cir. 1977).

[59] 32 FERC at p. 61,042.

[60] In footnote 71 we cited as support the treatise of Professors Areeda and Turner. We, however, incorrectly referred to the title of the treatise as *Antitrust Analysis.* That, of course, is the title of Professor Areeda's casebook. The correct title of the treatise is *Antitrust Law.*

said, because, if the customer bought gas from another supplier, it would still have to pay the supplier for the gas and pay Transwestern's minimum bill. Hence the analogy between requirements contracts on the one hand and minimum bills on the other would still hold true. The third factor was that the record showed that the supply of gas in the future in the markets served by Transwestern would exceed demand.

Transwestern does not dispute the first or third factors. But it does the second. It argues that the factors affecting its customers' decisions to buy gas from one supplier rather than another are more complicated than we described them. With respect to Pacific, Transwestern points out that purchasing decisions by utilities in California are controlled by the CPUC's purchasing policy. This is true. But it does not affect our point that Transwestern's minimum bills act like requirements contracts. Indeed, it strengthens our point. As Transwestern has explained the CPUC's current purchasing policy, SoCal must first buy a minimum amount of gas from each of its suppliers. It must then buy gas to satisfy its suppliers' minimum bill requirements. SoCal's remaining purchases are based on each supplier's commodity rate.[61] Thus, under the CPUC's policies SoCal would have to buy minimum bill volumes from Transwestern even if it could save money by buying gas from another supplier and paying Transwestern's minimum bill.[62]

With respect to Northwest Central, Transwestern points out that Northwest Central's purchasing decisions are affected by a myriad of factors, including take-or-pay obligations to producers and the volumetric conditions in the

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[61] *See* Transwestern's motion of May 31, 1985, to reopen the evidentiary record, at 7; *see also,* Transwestern's transmittal letter in Docket No. RP85-175-000, at 4.

[62] Transwestern's transmittal letter in Docket No. RP85-175-000, at 4, explicitly makes this point.

certificate authorizing construction of the Rawlins-Hesston line.[63] This is also true. But it does not detract from our finding. As we have seen, Northwest Central follows a policy of buying gas on a net-back target price basis.[64] Such a policy will necessarily require Northwest Central to take into account the costs it will incur under Transwestern's minimum bills if it does not purchase gas from Transwestern.

Transwestern's third point is that Opinion No. 238 is based on a misunderstanding of the role of competition under the Natural Gas Act. The true role of competition under the Act, Transwestern contends, is set forth in *United States* v. *El Paso Natural Gas Co.*, 376 U.S. 651, 659-60 (1964). The Court there said: "Once the Commission grants authorization to construct facilities or to transport gas in interstate commerce, once the distribution contracts are made, a particular market is withdrawn from competition. The competition then is for the new increments of demand that may emerge with an expanding population and with an expanding industrial or household use of gas."

We disagree. The Court's statement was not a description of competition under the Act in all instances. It was a description of competition as it then existed in the California market. That competition was characterized by the fact that El Paso, the only pipeline serving California at the time, was unable to satisfy demand.[65] This, of course, is

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[63] *See* note 18 *supra.*

[64] *See* note 18 *supra.*

[65] A number of Commission decisions establish that through the end of the 1960's the market for gas in southern California was constrained by supply, not demand. *See, e.g., El Paso Natural Gas Co.*, 5 FPC 115, 120-22 (1946); *El Paso Natural Gas Co.*, 7 FPC 908, 910-11 (1948); *El Paso Natural Gas Co.*, 11 FPC 1071, 1075-76 (1952); *El Paso Natural Gas Co.*, 16 FPC 1354, 1355 (1956); *El Paso Natural Gas Co.*, 19 FPC 393, 396 (1958); *Transwestern Pipeline Co.*, Initial Decision, 22 FPC 407, 412-13 (1959); *Pacific Northwest Pipeline Co.*, Initial Decision, 22

no longer the characteristic of the markets in southern California and the Kansas City area served by Transwestern. These markets are characterized by a surplus of supply.[66] Competition in such a market is not for new increments of demand. It is for the demand that already exists. Nothing in the Supereme Court's description of competition in California in the late 1950's prohibits this competition. As the Fourth Circuit has said on this very point: "We do not construe [the Supreme Court's] dictum [in the *El Paso* case] to prescribe an immutable rule for the regulation of pipelines. The Natural Gas Act does not expressly limit a second supplier to incremental sales, and neither the Commission nor the courts have imposed such a rigid exclusion."[67]

Having found then that Transwestern's minimum bills will likely restrain trade, we turn to the justifications for the restraint. In *Atlantic Seaboard Corp.,* Opinion No. 553, 38 FPC 91, 95 (1967), *aff'd,* 404 F.2d 1268 (D.C. Cir. 1968), the Commission set forth three "economic factors which usually justify a minimum commodity rate in a pipeline tariff."[68] Each of these factors addresses a specific regulatory problem. If a minimum bill remedies one of these problems, it may be justified.

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FPC 1102, 1107 (1959); *Transwestern Pipeline Co.,* Initial Decision, 36 FPC 262, 296-97 (1965); *Pacific Gas Transmission Co.,* Opinion No. 549, 40 FPC 1147, 1170 (1968) (White, C., dissenting). The record in this case makes clear that this relationship between supply and demand in the southern California market continued into 1982. *See* Opinion No. 238, 32 FERC at p. 61,039 n. 23.

[66] *See* Opinion No. 238, 32 FERC at p. 61,039 n. 23 and p. 61,042 n. 71.

[67] *Atlantic Seaboard Corp.* v. *F.P.C.,* 397 F.2d 753, 758-9 (4th Cir. 1968).

[68] *See also,* Order No. 380, *FERC Statutes and Regulations, Regulations Preambles 1982-1985* at 30,960; Notice of Proposed Rulemaking, *FERC Statutes and Regulations, Regulations Preambles 1982-85* ¶ 32, 335, at p. 32,669 (1983).

The first problem concerns the pipeline's recovery of its fixed costs. With respect to this problem the Commission in *Atlantic Seaboard* said that a minimum bill may be justified if it provides for the "recovery of that portion of a pipeline's rates which allocate fixed charges to the commodity component . . ."[69] In Opinion No. 238, we held that Transwestern's minimum bills do not satisfy this factor.

On rehearing, Transwestern argues that our holding is a "renunciation of over half a century of Supreme Court decisions, and the [Atlantic] *Seaboard* case itself, which recognized that a regulated company is entitled to recover its prudently incurred costs . . ."[70] We disagree. The argument reflects a fundamental confusion about the issue here.

The Supreme Court cases Transwestern relies upon stand for the proposition that a pipeline is entitled to a rate that provides it the *opportunity* to recover its fixed costs, including a fair profit, if it sells the volumes used to design rates.[71] But no such issue exists here.[72] Rather, the issue is whether

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[69] *Atlantic Seaboard Corp.*, 38 FPC at 95.

[70] Application for Rehearing, at 34.

[71] Transwestern cites *Bluefield Water Works & Improvement Co.* v. *Publ. Serv. Comm'n*, 262 U.S. 679 (1922). But by referring to "Supereme Court decisions" we assume that Transwestern also has in mind such decisions as *F.P.C.* v. *Hope Natural Gas Co.*, 320 U.S. 591 (1944), *F.P.C.* v. *Natural Gas Pipeline Co.*, 315 U.S. 575 (1942), and *Southwestern Bell Telephone Co.* v. *Publ. Serv. Comm'n.*, 262 U.S. 276, 290 (1922) ("Upon the capital so invested the Federal Constitution guarantees to the utility the *opportunity* to earn a fair return." [Emphasis added]) (Brandeis and Holmes, JJ., concurring).

[72] For the dockets before us, all issues concerning the rate level that will give Transwestern the opportunity to recover its costs on the basis of what it is realistically expected to sell have been settled.

Of course, those rates assumed that Transwestern would have in effect minimum bills. Hence it is possible that without its minimum bills those rates would not give Transwestern the opportunity to recover its costs. But this is no objection to our

Transwestern's rate schedules should include a billing device to guarantee Transwestern—or to use Transwestern's terminology, entitle it to—recovery of all its fixed costs, including its profit, if, because of competition, it does not sell the volumes used to design its rates. We know of nothing in any Supreme Court case that supports the proposition that a pipeline is to be guaranteed recovery of all its fixed cost. Indeed, the Supreme Court has decisively rejected that proposition. "When [plant is] included [in rate base], the utility gets its return not from capitalizing the maintenance cost, but from current earnings by rates sufficient, having in view the character of the business, to secure a fair return upon the rate base, *provided the business is capable of earning it.* But regulation does not insure that the business shall produce net revenues . . ."[73]

Nor can it be fairly argued that the *Atlantic Seaboard* case supports such a proposition. To be sure, in that case the

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decision. Our decision is effective prospectively from the date we issue this order. Transwestern therefore has had ample time to exercise its contractual rights to file revised rates to reflect our decision. Transwestern did so in Docket No. RP85-175-000 at the same time it filed the instant application for rehearing. *See Transwestern Pipeline Co.,* 32 FERC ¶ 61,310, (1985). (We suspended this filing for five months to become effective on February 1, 1986. During the suspension period the parties entered into a settlement. At Transwestern's request we put into effect on February 1, 1986, the settlement rates in lieu of the filed rates pending our decision on the settlement. *See Transwestern Pipeline Co.,* 34 FERC ¶ 61,202 [1986].)

Because Transwestern has the opportunity to file revised rates to reflect our decision and has done so, we see no merit to its argument that our decision amounts to an unconstitutional confiscation of property. All the Constitution entitles Transwestern to is the right to have in effect rates that give it the opportunity to recover its costs. *See* note 71 *supra.* Transwestern has been accorded that right.

[73] *F.P.C.* v. *Natural Gas Pipeline Co.,* 315 U.S. at 590 (emphasis added).

Commission and the court recognized that, because pipelines have high fixed costs, they need to be guaranteed substantial fixed cost recovery. In Opinion No. 238 we held the same. But, as we also pointed out in Opinion No. 238, the Commission and the court in the *Atlantic Seaboard* case also recognized that the need to guarantee substantial fixed cost recovery has to be balanced against the need to expose pipelines to the incentive to minimize costs competition provides. Such balancing precludes a rule that would guarantee the pipeline recovery of all its fixed costs.[74]

To balance these conflicting interests some measure is needed to determine how much guaranteed fixed cost recovery is enough and how much is too much. In Opinion No. 238 we rejected the notion that this measure could be provided by simply determining that a certain percentage figure, such as 90 percent or 60 percent, should be applied to the fixed costs component of the commodity charge. In various ways Transwestern, El Paso, and the EOC Companies argue that this was erroneous. We see no merit to these arguments. Our reason for rejecting this approach is simple. Pipelines in general and Transwestern in particular have demand charges. These guarantee recovery of all the fixed costs included in the demand component. Thus, minimum bills

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[74] If the Commission had intended to establish such a rule in the *Atlantic Seaboard* case, then the case was wrongly decided, for the commodity components of the pipelines' rates included some fixed costs. *See Atlantic Seaboard Corp.* v. *F.P.C.* 404 F.2d at 1271 n. 6. Moreover, in a number of cases the Commission has rejected mechanisms that had such an effect. *See, e.g., Colorado Interstate Gas Co., 27* FERC ¶ 61,315 (1984) (rejecting a demand charge that would have guaranteed recovery of 100 percent of the pipeline's fixed costs); *Atlantic Seaboard Corp.,* 28 FPC 860 (1962) (rejecting a 100 minimum commodity bill and substituting therefor an 80 percent minimum bill); *Transwestern Pipeline Co.,* Opinion No. 328, 22 FPC 391, modified, Opinion No. 328-A, 22 FPC 542 (1959) (rejecting a 100 percent minimum bill and subsituting therefor a 91 percent minimum bill).

are not the only means of guaranteeing the recovery of fixed costs; they are a means of providing additional guarantees of fixed cost recovery. In these circumstances we cannot strike the proper balance between the need to guarantee substantial fixed cost recovery and the need to expose the pipeline to competition simply by deciding that a certain percentage of the fixed costs in the commodity charge should be guaranteed. That would be to ignore the effect of the demand charge. Instead, we must look at the total rate, both the demand charge and the commodity charge. The combination of the two, together with any minimum commodity bill, should provide both the requisite guarantees and incentives.[75]

In Opinion No. 238 we held that the proper measure for balancing the conflicting interests is that a pipeline should not be assured of its return on equity, related income taxes, and fixed production costs but should be assured of recovering its other fixed costs. Transwestern and El Paso argue that this holding is sheer *ipse dixit.* This is obviously incorrect. The parties have overlooked footnote 76 to Opinion No. 238.

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[75] The EOC Companies argue that this holding is inconsistent with numerous cases where the Commission has approved minimum bills determined by applying a percentage figure to the commodity bill. We think this argument largely misses the issue. The immediate issue here is not whether there should be a minimum bill determined by applying a percentage figure to the commodity charge. As we point out below, *infra,* p. 30, that may or may not be appropriate. Rather, the issue is how to determine the appropriate level of guaranteed fixed cost recovery. Our point in Opinion No. 238 and here is that this issue cannot be resolved by debating whether the percentage figure should be 90 percent or 60 percent or zero percent. Instead, the issue must be resolved by taking into account the fixed cost recovery guaranteed by the demand charge. (This response does not fully exhaust the issue raised by the EOC Companies' argument. We will touch on it again. *See infra,* pp. 48-50.)

El Paso also argues that our holding is contrary to the *Altantic Seaboard* case because that case did not distinguish between equity and non-equity fixed costs. We agree that in *Atlantic Seaboard* the Commission did not distinguish between equity and non-equity fixed costs. But still we see no inconsistency. Columbia's case for justifying its minimum bill proposals was essentially that without the minimum bills it would lose base load sales and that any growth in peaking services would be insufficient to prevent rate increases to full requirements customers. The judge, the Commission, and the court found this argument implausible largely because "Columbia had . . . filed restructured tariffs . . . designed to make the Columbia companies more competitive and to encourge growth of high load factor sales. These tariffs lower the commodity rate and reflect a substantial reduction in the amount of fixed costs allocated to the commodity part of the rates, thus reducing the impact of lost commodity sales on full requirements customers."[76] Consequently, the Commission had no need to — and did not — delve deeply into just what would or would not satisfy the first factor. It left that to another day.[77] That day is now. Hence there can be no inconsistency.

El Paso also argues that our holding is inconsistent with another *Atlantic Seaboard* case. This case was the one in which the Commission established the *Seaboard* method of cost classification and rate design. In doing so the Commission noted that "as far as cost incidence is concerned return and depreciation are alike as two peas in a pod."[78] El Paso argues that just as in that case there was no basis for distinguishing between depreciation and return so also here. We disagree. In the *Atlantic Seaboard* case the Commission was

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[76] *Atlantic Seaboard Corp.* v. *F.P.C.* 404 F.2d at 1270-71.

[77] *Atlantic Seaboard Corp.*, 38 FPC at 96.

[78] *Atlantic Seaboard Corp.*, 11 FPC 43, 55 (1952).

discussing cost causation. But in this case our concern is not with cost causation; it is with balancing the need for a guarantee of substantial fixed cost recovery against the need to expose the pipeline to the incentives competition provides. This cannot be done simply by looking at what causes the costs to be incurred.[79]

Depending on how the pipeline's costs are classified and its rates designed, it may be necessary to include in the pipeline's rate schedules a minimum commodity bill to guarantee to the pipeline sufficient fixed cost recovery even though competition might be excluded as a result.[80] In Opinion No. 238 we held that it was unnecessary to do so for Transwestern's rate schedules because there is a less restrictive way of achieving the same objective. This alternative is

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[79] El Paso also contends that our holding is inconsistent with two other cases. One is the Notice of Proposed Rulemaking, Elimination of Variable Costs from Certain Natural Gas Pipeline Minimum Commodity Bill Provisions, *FERC Statutes and Regulations*, ¶ 32,334, at p. 32,669 (1983). But all the Commission did there was to describe how the typical minimum commodity bills then in effect operated. Hence there in no inconsistency. The other case is *Colorado Interstate Gas Co., 27* FERC ¶ 61,315 (1984). We will address this argument below. *See infra* pp. 44-45.

[80] For example, the modified fixed-variable method may not be appropriate for classifying a pipeline's costs and designing its rates. Instead, the *United* method may be the appropriate method. Under such a method only 25 percent of the pipeline's fixed transmission costs are classified to the demand component and recovered through the demand charge. The remaining 75 percent of the pipeline's fixed transmission costs and all of its fixed production costs are classified to the commodity component and recovered through the commodity charge. This may not give the pipeline the requisite assurance of fixed cost recovery. Hence a minimum bill may be appropriate in such an instance. But before we could approve a minimum bill in that instance we would have to answer the factual questions propounded by the court in *Mississippi River Transmission Corp. v. F.E.R.C.*, 754 F.2d 925 (D.C. Cir. 1985)

to classify Transwestern's costs and design its rates according to the modified fixed-variable method. Under this method all fixed costs except return on equity, related income taxes, and production related fixed costs are classifed to the demand compenent and recoverd through the demand charge. Hence Transwestern will be guaranteed recovery of these costs. The remaining fixed costs are classified to the commodity component and recovered through the commodity charge. Transwestern will recover these costs only if it sells gas. Thus, the recovery of these costs will depend on Transwestern's maintaining a competitive price for its gas.

Transwestern argues that the modified fixed-variable rate design is not an adequate substitute for a minimum bill. This is so, Transwestern says, because "it by no means assures the recovery of fixed costs assigned to the commodity charge . . . "[81] Stated in so naked a form, Transwestern's basic argument in the case is exposed for what it is: a plea that its profit be protected from competition. Such a plea is contrary to the basic premise of the Act. "Investors in the natural gas industry, although granted an *opportunity* for a 'fair return', are by no means guaranteed freedom from risk or competition. Such assurance would, in a case such as this, deprive competitors of the right to compete, inhibit efficient allocation of resources and deny ultimate consumers the lowest prices to which they are entitled."[82]

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[81] Transwestern's Application for Rehearing, at 35.

[82] *Lynchburg Gas Co.* v. *F.P.C.*, 336 F.2d 942, 949-50 (D.C. Cir 1964) (Washington and Burger, JJ., concurring) (emphasis in original).

> In our line of work it pays never to say "never." So we do not wish to be understood as saying that a pipeline is never entitled to a guarantee of fixed cost recovery greater than is provided by the modified recovery geater than is provided by the modified fixed-variable rate design. We can imagine situations where an exception to the general rule would be appropriate. Indeed,

The second problem the Commission identified in *Atlantic Seaboard* as one that a minimum bill might appropriately remedy concerns the impact on the pipeline's full requirements customers of a partial requirements customer's decision to buy gas from an alternative supplier. The problem here is simply stated. The pipeline has incurred fixed costs as a result of building its system to supply all the needs of its customers. If a partial requirements customer substantially reduces its purchases over the long-term, allocation factors and billing determinants would, assuming all other things remained the same, be changed in the next rate case. The result would be that some of the costs previously allocated to, and recovered from, the partial requirements customer might be allocated to, and recovered from, the full requirements customers, which have no alternative source of supply. A minimum bill may be justified if it alleviates this shifting of costs by requiring the paritial requirements customer to pay a portion of the fixed cost component of the commodity charge or by continuing to buy gas from the pipeline.

In Opinion No. 238 we did not address this possible justification for Transwestern's minimum bills. Transwestern argues that this omission was erroneous.[83] We agree with Transwestern that we should have addressed this possible justification for its minimum bills. But we do not agree with Transwestern that its minimum bills are justified as a way of protecting its full requirements customers.

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when Transwestern was first certificated, it presented a situation where an exception was appropriate. But it does not now. *See infra* pp. 48-50. Hence we see no reason to depart from the general rule.

[83] Transwestern argues that the cost-shifting impact on Pacific must also be considered even though it has the opportunity to purchase gas from other suppliers. We disagree. The point of the justification is that competition may be restrained if necessary to protect the defenseless. Pacific is anything but that.

That a minimum bill may be justified as a way of protecting full requirements customers from the cost-shifting consequences of competition for the partial requirements customer's business does not mean the full requirements customers are immune from feeling these consequences in all instances. "Just as competition may pinch the [pipeline], so too may it pinch the full requirements customers tied to that system."[84] Hence we cannot approve a minimum bill simply because there exists the slightest possibility that some costs will be shifted to full requirements customers. Instead, we must balance the harm competition might cause the full requirements customers against the benefits competition provides to the partial requirements customer and to the pipeline's other customers.

To balance these conflicting interests the initial questions that must be answered are: Will the full requirements customers be affected by the partial requirements customer's decision? If so, by how much? These questions are intensely factual. They turn on the resolution of such subsidiary questions as: Will the partial requirements customer in fact reduce its purchases? If so, by how much? Will the reduction be short-term or long-term? Will the pipeline reduce its costs to compete for the partial requirements customer? And, will the pipeline increase sales to other customers, be they existing or new?

In short, we need a proper record to determine whether Transwestern's minimum bills are justified as a way of protecting its full requirements customers. But there is no record on this issue. Transwestern did not seek to justify its minimum bills as a way of protecting its full requirements customers.[85]

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[84] *Atlantic Seabord Corp.* v. *F.P.C.*, 404 F.2d at 1273.

[85] It might be argued that we are being inconsistent in our treatment of the first and second *Atlantic Seaboard* justifications.

This does not end the matter, however. The fate of the full requirements customers should not turn on Transwestern's default. The question therefore is whether we should stay our decision so that a full record can be developed. Although the resolution of this question is not wholly free from doubt, we conclude that we should not.

We have some idea of the impact our decision might have on Transwestern's full requirements customers. At the same time Transwestern filed the instant application for rehearing it also filed revised rates in Docket No. RP85-175-000. That filing contained two sets of rates. One set of rates included a billing devise that was in effect a 60 percent minimum bill.[86] The other set did not. The rates for the full requirements customers under the latter set are about 5.5 percent higher than under the former.[87] This impact, though not trivial, is

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Both require us to balance the benefits of competition against its harm. Yet we require a detailed, factual record to perform this balancing only for the second justification. We, however, see no inconsistency. We deal with problems of guaranteeing fixed cost recovery constantly. It is implicit in every rate design decision. So we have a good sense of where the balance lies. But until very recently we have not had to deal with the cost-shifting consequences of partial requirements customers swinging off the pipeline. So our experience on this issue is limited. In these circumstances a detailed factual record is necessary.

[86] *See Transwestern Pipeline Co.*, 32 FERC at p. 61,723.

[87] Specifically, the rates for the Small General Service and Right-of-Way customers under the former set are $3.5027 and $3.3477 per Dth, respectively. Under the latter set the rates are $3.6917 and $3.5367 per Dth, respectively.

The Commission accepted the latter set of rates for filing and, because the rates had not been shown to be just and reasonable, set the matter for hearing. *Id.* at pp. 61,724-25. The parties then entered into a settlement. The settlement rates are lower than the rates Transwestern initially proposed. Specifically, the rate for the Small General Service customers is $3.0947 per Dth while the rate for the right-of-way customers is $2.9437 per Dth. The settlement rates are currently in effect in lieu of the filed rates pending our consideration of the settlement. *See Transwestern Pipeline Co.*, 34 FERC ¶ 61,202 (1986).

modest. We do not think it outweighs the benefits increased competition will provide to the millions of consumers in the southern California and midwestern markets served by Transwestern's partial requirements customers.

Some might argue that this sort of "the greater good" argument is no argument at all. The important point is that full requirements customers will be hurt; this should not happen.[88] Our response to an argument such as this is that we expect any impact on the full requirements customers to be at most short-term. Transwestern makes over 99 percent of its sales to its partial requirements customers. With its profits at risk under the modified fixed-variable method of cost classification and rate design Transwestern will not long be able to ignore the loss of sales to its partial requirements customers. Given its duty to its shareholders to maximize profits, Transwestern will have to reduce its gas costs. Any such reduction will be reflected in the rates for the full requirements customers. This is extremely significant for the full requirements customers. Gas costs represent about 80 percent of the costs allocated to them. Hence even a modest reduction in gas costs resulting from Transwestern's efforts to compete for sales to its partial requirements customers will overwhelm any increase in the fixed costs allocated to the full requirements customers.

This is not mere theory. Since the Commission issued its minimum bill rule eliminating variable costs from minimum bills, Transwestern has taken numerous steps to reduce its gas costs so that it can compete for sales to its partial requirements customers.[89] Given Transwestern's evident

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[88] The full requirements customers, however, have not made this argument. Indeed, they have made no arguments at all, for they have not participated in this case or intervened in docket No. RP85-175-000.

[89] *See* Opinion No. 238, 32 FERC at p. 61,033 *citing* Order No. 380-C, slip op. at 14 n. 13. The Commission there noted

intent to compete for its partial requirements customers' business, we have every reason to believe it will continue to reduce its gas costs. Hence we do not think that a minimum bill is required to protect Transwestern's full requirements customers.[90]

The third problem the Commission identified in *Atlantic Seaboard* as one that a minimum bill might appropriately remedy is presented by the "minimum take-or-pay obligations which a pipeline has to its suppliers." The problem is quite simply stated. In the course of contracting for gas to supply its customers' needs, the pipeline may have agreed to take a certain amount of gas from the producer or pay the producer if it does not. If a partial requirements customer then decides to buy some of its gas from another supplier, the pipeline may have to pay the producer for gas it did not

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that as a result of Transwestern's second PGA filing of 1984, effective October 1, 1984, Transwestern's commodity rate was lower than El Paso's. By exercising market out clauses Transwestern has continued to reduce its gas costs since then and has therefore been able to maintain its commodity rate at a level below El Paso's.

[90] Moreover, if Transwestern's efforts to increase its sales to its partial requirements customers are successful, fixed costs may be shifted back to the partial requirements customers. Moreover, by reducing its gas costs to compete for the business of its partial requirements, Transwestern may be able to attract new customers. If it does so, some of the fixed costs allocated to the full requirements customers will be allocated to the new customer. (In this regard we note that Transwestern has, in Docket No. CP86-211, applied for a certificate to sell gas to a new customer, Southwest Gas Company.) Additionally, if Transwestern increases its transportation for its partial requirements customers, fixed costs will also be shifted back to the partial requirements customers. This is significant because Transwestern has agreed as part of the settlement in Docket No. RP85-175-000 to become an open access transporter under the terms of Order No. 436 [*FERC Statutes and Regulations, Regulations Preambles 1982-85* ¶ 30,665]. Doing so will give Transwestern greater opportunity to transport gas. *See* 50 Fed. Reg. 42,408 (1985).

take. Typically, the pipeline's contract with the producer allows the pipeline to make up its deficient takes over a period of years. Most pipelines do so. Hence the payments are really prepayments for gas to be taken later. Nevertheless, the pipeline has to finance it prepayments and may be entitled to recover the costs of this financing from ratepayers. The usual way this is done is by adding the prepayments to the pipeline's rate base and allowing the pipeline to earn a return on them.[91] As a consequence, all the pipeline's customers will bear the cost of the prepayments. This seems unfair. The pipeline's increased financing costs are caused by the partial requirements customer's decision to buy gas from another supplier. It, not the other customers, should pay the pipeline's increased costs. A minimum bill may be justified if it remedies this problem.

Following the Commission's analysis of this question in the minimum bill rule, we held in Opinion No. 238 that a minimum bill is not justified if its seeks to remedy this problem by preventing the pipeline from incurring take-or-pay liabilities by foreclosing competition for the customers' business. "Rather, the point of justification is that a minimum bill may be permissible if it is used to ensure that the carrying costs associated with take-or-pay liabilities will be borne by the customers that caused the liabilities to be incurred."[92] Since there is no connection between the minimum bill payments the customers would make under Transwestern's rate schedules and the carrying costs associated with take-or-pay liabilities Transwestern could legitimately recover from its partial requirements customers, we concluded that Transwestern's minimum bill was not justified under this standard.

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[91] *See* 18 C.F.R. § 154.63.

[92] 32 FERC at p. 61,032.

Transwestern, El Paso, and the EOC Companies argue that this conclusion is erroneous. We see no merit to these arguments. Several arguments, however, warrant brief discussion.

Transwestern argues, in essence, that our conclusion is inconsistent with *Atlantic Seaboard.* This is incorrect. In *Atlantic Seaboard* Columbia did not seek to justify its minimum bills as a remedy for take-or-pay problems. Hence the Commission had no need to — and did not — explain how a minimum bill would have to deal with a pipeline's take-or-pay obligations to be justified. All the Commission had to do — and all that it did — was to point out that a minimum bill might be justified if it dealt with the pipeline's take-or-pay obligations. Hence, there is no inconsistency.

Transwestern also argues that, if a minimum bill is justified under the take-or-pay justification only because it ensures recovery of the carrying costs of take-or-pay liabilities from the customer that caused the costs to be incurred, the justification merely reiterates the second. This is almost correct. As the Commission recognized in the minimum bill rule, the take-or-pay justification is an "outgrowth" of the second justification. Both seek to protect full requirements from the actions of partial requirements customers. But, as the Commission also recognized in the minimum bill rule, costs associated with take-or-pay liabilities require "special consideration."[93]

The EOC Companies argue that we have not given the take-or-pay problems the "special consideration" required by the minimum bill rule. We disagree. The "special consideration" the minimum bill rule suggests be given to take-or-pay problems is the possibility of developing a mechanism that would require a particular customer to pay the carrying

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[93] *See* Order No. 380, *FERC Statutes and Regulations, Regulations Preambles 1982-1985* at ¶ 30,971.

costs on the pipeline's take-or-pay liabilities if it can be demonstrated that the customer's cutbacks caused the liabilities to be incurred. Nothing in Opinion No. 238 is inconsistent with this. Our sole point on the take-or-pay issue was that Transwestern's minimum bills did not do this.

El Paso argues that a minimum bill, such as Transwestern's, that is limited to recovering fixed costs only is an appropriate way of dealing with take-or-pay problems. El Paso argues that such a minimum bill would not be inconsistent with the minimum bill rule because, unlike the minimum bills considered there, a minimum bill limited to fixed costs would always be cost-based. We think this is irrelevant, for as the Commission made clear in *Atlantic Seaboard*, if a minimum bill is to be justified as a remedy for one of the problems identified in that case, it must be specifically designed to remedy that problem and nothing more.[94] Transwestern's minimum bills are not.

In addition to the three *Atlantic Seaboard* justifications for minimum bills, the judge added another by adopting a proposal made by El Paso.[95] The justification was that in order to avoid placing a pipeline in economic jeopardy by subjecting it to a governmentally-created competitive disadvantage a pipeline must be placed on an equal footing with its competitors. Thus, if a pipeline's competitor has a minimum bill at a certain level, the pipeline should have a minimum bill at the same level. Following this theory the judge held, as El Paso recommended, that since Transwestern's major competitor in the southern California market, El Paso, had

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[94] *Atlantic Seaboard Corp.*, 38 FPC at 96 ("In designing a justifiable minimum commodity rate Columbia should carefully consider the factors . . . and should avoid one designed to discourage customers from seeking another source of supply."); *see also, Mississippi River Transmission Corp.* v. *F.E.R.C.*, 754 F.2d at 950 (D.C. Cir. 1985).

[95] *See* Exh. 55, pp. 22-23, for El Paso's proposal.

agreed to use a 60 percent minimum bill in its rate schedules for sales to Pacific, Transwestern should have a minimum bill of 60 percent.

In Opinion No. 238 we rejected the judge's justification for Transwestern's minimum bill.[96] We did so for several reasons. One was that we adhered to the rule established in the *Atlantic Seaboard* case that a pipeline's minimum bill must be justified on the facts of that pipeline, not the facts of its competitors. We explained that the basis for this rule was that regulation requires a decision as to what is fair to both the pipeline and consumers. Setting the pipeline's minimum bill on the basis of other pipelines' minimum bills ignores the consumers.[97]

El Paso challenges this reasoning. It argues that denying one pipeline a minimum bill while allowing another pipeline in the market to have a minimum bill can significantly bias competition. This is especially so in the California market because the CPUC's purchasing policy gives priority to purchases within minimum bill levels. To alleviate this problem El Paso contends that we should, as the judge did, establish comparable minimum bills for the competitors in the California market. We disagree.

The effect of El Paso's proposal is to divide the southern California market among the competing pipelines. As El Paso's witness explained, the effect of establishing comparable minimum bills would be "to provide a pro rata share . . . of the market."[98] If El Paso and the other pipelines supplying the southern California market themselves agreed to a pro rata sharing of the market, the agreement would be a

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[96] 32 FERC at pp. 61,032-61,034.

[97] *Id.* at p. 61,033.

[98] Tr. 2735.

*per se* violation of the antitrust laws.[99] Of course, we do not have such an agreement before us; we are asked to impose the division. But we do not think this makes any real difference. Agreements among competitors to divide markets are not condemned simply because competitors have agreed. They are condemned because they eliminate rivalry among competitors, thereby preventing the more efficient firms from expanding and protecting the less efficient, all to the detriment of consumers. We see no reason to ignore this fact.[100]

Nevertheless, we do not enforce the antitrust laws.[101] Hence we are not bound by the *per se* rule applicable to agreements to divide markets under the antitrust laws. So we could adopt El Paso's proposal. But before we could or would do so we would need to find that the effects of the proposal would not be those that have led courts to condemn agreements to divide markets or, at least, that the proposal, despite its effects, is necessary to achieve some objective meriting recognition under the Natural Gas Act.

El Paso's witness attempted to support both findings. First, he testified that the proposal would not have the same effect as agreements among competitors to divide markets. This was so, the witness said, because the *per se* rule condemning agreements to divide markets was developed in the context of unregulated industries. The competitors here,

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[99] *See, e.g., United States* v. *Topco Associates*, 405 U.S. 596 (1972).

[100] That El Paso has proposed to set the minimum bill for the pipelines at 60 percent of annual contract quantities, thus leaving 40 percent of the market open for competition, does not affect our conclusion. The proposal still eliminates competition for 60 percent of the market. As one of El Paso's witnesses said, the proposal puts a "floor on the down side. . . ." Tr. 2808.

[101] *California* v. *F.P.C.*, 369 U.S. 482, 484-85 (1962).

however, are subject to our rate regulations.[102] But courts have seen no significance in this fact. They condemn agreements to divide markets among regulated entities just as strongly as they do such agreements among unregulated entities.[103] And we see no reason we should. Rate regulation is a means of prohibiting a firm from earning monopoly profits. Earning monopoly profits is one reason agreements to divide markets are condemned. But this is not the only reason, or even the most important reason, for condemning such agreements. The real problem with agreements to divide territory is that they necessarily constrict the "firm capable of expansion and thus increase cost. The least efficient producers are often protected and the advantages of a less costly method of distribution and production are lost to

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[102] Tr. 2771. The witness' answer was cut off by counsel. So the witness may also have wanted to base his testimony on another aspect of regulation mentioned in his direct testimony, namely, our control over entry and exit. *See* Exh. 64-A, p. 9. We understand how our control over entry and exit makes competition in the natural gas industry different from competition in an unregulated industry where a firm can, at least in theory, enter or leave a market quickly in response to changes in price. But we do not see, and neither the witness nor El Paso has explained, how our control over entry and exit would in any way diminish the anticompetitive effect of a division of markets among the competitors we have permitted to enter a market.

[103] *Gainesville Utilities Dept.* v. *Florida Power & Light Co.*, 573 F.2d 292 (5th Cir.), *cert. denied*, 439 U.S. 966 (1978); *Montana-Dakota Utilities Co.* v. *Williams Electric Coop.*, 263 F.2d 431 (8th Cir. 1959); *Pennsylvania Water & Power Co.* v. *Consolidated Gas, Electric Light and Power Co.*, 184 F.2d 552 (4th Cir. 1950), *cert. denied*, 340 U.S. 906 (1951). We note that in a case related to the Pennsylvania Water & Power case the United States Court of Appeals for the District of Columbia Circuit reached a different conclusion. *See Pennsylvania Water & Power Co.* v. *F.P.C.*, 193 F.2d 230 (1951), *aff'd* 343 U.S. 414 (1952). But, as the same court has recognized, its subsequent decisions have eroded the rationale of that case. *See Northern Natural Gas Co.* v. *F.P.C.*, 399 F.2d 953, 969 n. 33 (1968).

the public."[104] When markets are divided rate regulation does nothing to alleviate this effect.

The witness also testified that eliminating Transwestern's minimum bill would have a long-run detrimental effect.[105] But the witness also testified that there could be long-run benefits.[106] More important, the witness made no study to determine how likely the long-run detriments are to occur.[107] Nor could he say when they would occur.[108] Testimony of this sort does not permit us to find that the elimination of rivalry among the competing pipelines in the southern California market is necessary.

What we have said here does not mean that the minimum bills of competitors are irrelevant. They are. But the relevance of a competitor's minimum bill is that it shows a minimum bill is justified under one of the *Atlantic Seaboard* standards. For example, the fact that a competitor has a minimum bill may mean that over the long-term significant fixed costs will be shifted to full requirements customers. But there is no need to consider this possibility here, for we do not find that Transwestern's minimum bills are justified under the *Atlantic Seaboard* standards.

Transwestern does not dispute our rejection of the judge's justification for its minimum bill. But it does raise two related arguments. First, Transwestern argues that we erred in considering the legality of its minimum bill without having before us a consolidated record dealing with the minimum bills of all the pipelines serving California. We disagree. To be sure, as we pointed out above, the minimum

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[104] Handler, Blake, Pitofsky, and Goldschmid, Cases and Materials on Trade Regulation 335 (1975). *See also* Exh. 97, p. 16.

[105] Tr. 2804.

[106] Tr. 2804-2807.

[107] Tr. 2819.

[108] *Id.*

bills of competing pipelines are relevant to our consideration of Transwestern's minimum bill. But the competing pipelines' minimum bills are relevant because they may show that Transwestern's minimum bill is justified under one of the *Atlantic Seaboard* standards. A consolidated record is not needed for us to consider this question.

Although a competing pipeline's minimum bill may not provide a sufficient basis to justify Transwestern's minimum bill under the *Atlantic Seaboard* standards, it may cause competitive injury to Transwestern by excluding it from the market just as Transwestern's minimum bill excluded El Paso. But a consolidated record is not needed for us to consider this question either. Just as El Paso did here, Transwestern can make its case that it has been competitively injured in a proceeding involving a particular pipeline. More important, a finding that the competing pipeline's minimum bill has excluded Transwestern would not, just as our finding that Transwestern's minimum bill had excluded El Paso did not, end the inquiry. We would then have to consider whether the competing pipeline's minimum bill was justified under the *Atlantic Seaboard* standards. A consolidated record is not appropriate for that inquiry. Pipelines differ. Individual circumstances must be considered. Hence we see no error in considering Transwestern's minimum bill now.

Transwestern's second argument is that we erred in refusing "to permit Transwestern to obtain discovery in order to develop a full record in this matter."[109] This sounds serious. It suggests that we prevented Transwestern from making its case that its minimum bills were justified under the *Atlantic Seaboard* standards in light of its competitor's minimum bills. But there is nothing serious about Transwestern's argument.

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[109] Transwestern's Application for Rehearing, at 54.

The only discovery dispute Transwestern has brought before us concerns its request to depose Mr. Robert J. Hohne, one of Pacific's officers.[110] What happened is this. Before the hearing began, Pacific filed Mr. Hohne's prepared direct testimony. Shortly before the hearing began, however, Pacific notified the parties that Mr. Hohne would not be available for cross-examination and that Mr. Lee K. Harrington, another of Pacific's officers, would adopt Mr. Hohne's testimony as his own and be available for cross-examination. At this point Transwestern moved to depose Mr. Hohne. The basis for Transwestern's motion was that, because Mr. Harrington had not been with Pacific for as long as Mr. Hohne, Mr. Harrington did not have the knowledge of the facts Mr. Hohne did.[111] Transwestern proposed to make Mr. Hohne's deposition part of the record, although Transwestern's counsel stated that the company would prefer to have Mr. Hohne "physically present and testify . . ."[112] In light of Transwestern's position the judge stated that, if Mr. Hohne had to be called as a witness, it would be better to subpoena him. The judge then asked Transwestern's counsel whether he still wanted to depose Mr. Hohne. Transwestern's counsel answered: "No, sir."[113] The judge accordingly denied Transwestern's motion to depose Mr. Hohne and deferred ruling on the question of whether to issue a subpoena until after Mr. Harrington had testified.[114] But, as far as we can tell, Transwestern never asked the judge to

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[110] *See* Brief on Exceptions for Transwestern, at 48. Since Transwestern does not identify in its application for rehearing how we have denied it discovery, we assume Transwestern's argument concerns the discovery dispute mentioned in its brief on exceptions.

[111] Tr. 339.

[112] Tr. 340.

[113] Tr. 341.

[114] Tr. 342.

issue a subpoena after Mr. Harrington had testified. In these circumstances, its hard to see how we have denied Transwestern discovery or prevented it from making its case.

## IV.

There are several miscellaneous arguments that merit some comment.

First, Transwestern, El Paso, and the EOC Companies each argue, though for different reasons, that our decision here is inconsistent with *Colorado Interstate Gas Co.*, 27 FERC ¶ 61,315, *reh'g denied,* 28 FERC ¶ 61,083 (1984). In that case the company had a 90 percent minimum bill in its rate schedules for sales to Natural Gas Pipeline Company. The minimum bill recovered both fixed and variable costs. The Commission affirmed the judge's ruling that this minimum bill was unlawful.[115] But the Commission reversed the judge's ruling that the proper remedy was to eliminate the minimum bill entirely and replace it with a demand charge that would guarantee to the company recovery of all its fixed costs. Instead, the Commission held, the proper remedy was simply to eliminate the variable costs from the minimum bill. Finally, the Commission directed that the question of the proper level of the minimum bill be investigated in the company's next rate case.[116]

According to the EOC Companies the inconsistency between *Colorado Interstate* and our decision in this case is simply in the result reached: there the Commission approved a minimum bill limited to recovery of fixed costs while here we have rejected such a minimum bill. We disagree. The results of the two cases are different but they are

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[115] 25 FERC ¶ 63,012 (1983).

[116] That investigation has been completed and the judge has issued his initial decision, *Colorado Interstate Gas Co.*, Docket No. RP85-122-000, 35 FERC ¶ 63,043 (1986). We intimate no views on the merits of the question here.

not inconsistent. The facts of the two cases are different. The rate schedule under which Colorado Interstate served Natural was a pure volumetric rate that, like Transwestern's commodity rate, recovers costs only if the pipeline sells the volumes used to design the rate.[117] The rate schedule, unlike Transwestern's, did not contain a demand charge. Thus, without a minimum bill Colorado Interstate, unlike Transwestern, had no guarantee of fixed cost recovery. Because, as we have said, it is important for pipelines to have a guarantee of substantial fixed cost recovery and because the minimum bill provided that guarantee to Colorado Interstate, a minimum bill limited to fixed costs was reasonable for Colorado Interstate. In Transwestern's case, however, a minimum bill is not needed to provide a guarantee of substantial fixed cost recovery.[118]

According to El Paso the inconsistency between *Colorado Interstate* and our decision here is in the treatment of equity-related costs. El Paso argues that in *Colorado Interstate* the Commission said that "where a minimum bill is justified, it should include equity-related costs."[119] In this case, however, we have held the opposite. The problem with this argument is that in *Colorado Interstate* the Commission did not say that a fixed cost only minimum bill should include equity-related costs. All the Commission said about equity-related

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[117] 25 FERC, at p. 65,015.

[118] The EOC Companies also point out that in Colorado Interstate the Commission said that "a minimum bill limited to recovery of the pipeline's fixed costs would be just and reasonable." 27 FERC at p. 61,583. The EOC Companies view this as a policy statement applicable to all pipelines. We disagree. If the EOC Companies view were correct, the statement would be a *sub silentio* overruling of the *Atlantic Seaboard* case. Nothing in the order suggests the Commission intended to do that. Hence the statement must be viewed in the context in which it was made. It means only that based on the record in the case a fixed cost minimum bill is reasonable for Colorado Interstate.

[119] Application for Rehearing for El Paso, at 9.

costs is that fixed costs include return on equity.[120] From this fact the Commission drew two conclusions. One was that a demand charge that guaranteed full recovery of fixed costs, as recommended by the judge, was inappropriate because it gave the company no incentive to be efficient. The other was that the level of Colorado Interstate's minimum bill should be investigated in the company's next rate case to ensure that the requisite incentive was provided. Thus, on this score *Colorado Interstate* is consistent with our conclusion here that pipelines should be exposed to the incentives competition provides to lower costs.[121]

According to Transwestern, the inconsistency between the two cases is in the procedures followed. Transwestern's argument goes like this: "The Commission issued *Colorado Interstate* on the same day it issued its minimum bill rule that eliminated variable costs from minimum bills on a prospective basis. Hence the record contained no evidence on the effect of eliminating variable costs from minimum bills. Because of this deficiency in the record the Commission postponed deciding the reasonableness of the *Colorado Interstate's* fixed cost minimum bill. In this case the record was also made before the Commission issued its minimum bill rule. Hence the record is similarly deficient. Yet the Commission did not postpone ruling on Transwestern's

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[120] 27 FERC at p. 583.

[121] The only difference between the two cases is that at the time of the Colorado Interstate decision the Commission had not yet decided that pipelines should generally not be guaranteed recovery of any equity-related costs. But it had by the time we decided this case. *See Texas Eastern Transmission Corp.*, 30 FERC ¶ 61,144 *reh'g denied in relevant part*, 32 FERC ¶ 61,056 (1985), *appeal docketed sub nom., Municipal Defense Group* v. *F.E.R.C.*, No. 85-1566, *et al.* (D.C. Cir. filed Sept. 9, 1985). Since we cannot withhold our decision in a case until we have resolved all conceivably related points, this difference hardly shows an inconsistency that amounts to unprincipled decision-making.

fixed cost only minimum bill until the company's next rate case." The problem with this argument is the assumption that the Commission found the record in *Colorado Interstate* deficient because it did not contain evidence on the effect of the minimum bill rule. The Commission made no such finding. Instead, the Commission found the record deficient simply because no party addressed "the question of whether [Colorado Interstate's] minimum bill should be predicated on Natural's taking 90 percent of its minimum contract quantity . . ."[122] The parties in this case, however, have addressed exactly this question. Hence there is no inconsistency. The records in the two cases are different.

Transwestern also argues that we have discriminated against it in favor of El Paso. To be quite frank, this argument is ambiguous. On the one hand, Transwestern may be arguing that we have discriminated against it in favor of El Paso in terms of minimum bill levels. On the other hand, Transwestern may be arguing that we have discriminated against it in favor of El Paso by accepting a settlement between El Paso and its customer that reduced El Paso's minimum bill from 75 percent to 60 percent while giving no weight to Transwestern's contracts with its customers.

If Transwestern is arguing the former, the answer is quite clear—we have not. Prior to December 17, 1983, El Paso's minimum bill for Pacific was, like Transwestern's, 91 percent of Pacific's Annual Contract Quantity (ACQ).[123] But Pacific's ACQ with El Paso was, unlike its ACQ with Transwestern, declining.[124] Hence El Paso's minimum bill was, unlike Transwestern's, much less than 91 percent of El

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[122] 27 FERC at p. 61,583. This deficiency is set forth in the judge's decision. 25 FERC at p. 65,021.

[123] Exh. 55, p. 5.

[124] *Id.*, p. 6.

Paso's delivery obligation to Pacific.[125] On December 17, 1983, El Paso put into effect rate schedules in Docket No. RP83-139 that provided for a fixed cost only minimum bill based on 75 percent of its delivery obligation to Pacific.[126] This case was subsequently settled with El Paso's agreeing to reduce its minimum bill to 60 percent until the earlier of July 1, 1985 or its next general rate case.[127] During this time Transwestern's minimum bill remained at 91 percent of Pacific's ACQ.[128] On July 1, 1985, El Paso put into effect revised rate schedules in Docket No. RP85-58. These rate schedules continued El Paso's 60 percent minimum bill.[129] July 1, 1985, was, of course, also the day we issued Opinion No. 238 in which we eliminated on a prospective basis Transwestern's minimum bill. But our order eliminating Transwestern's minimum bill is not effective until we issue this order on rehearing.[130] What was effective on July 1, 1985, was our order approving an interim settlement in this case. Pursuant to this settlement Transwestern agreed to reduce its minimum bill to Pacific to 60 percent of ACQ until our order on rehearing in this proceeding issues.[131] Thus, it was not until July 1, 1985, that Transwestern's minimum bill was reduced to a level comparable to El Paso's.

Things did not remain quiet on the El Paso front for long. On August 14, 1985, we approved a settlement in El Paso's

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[125] *Id.*, pp. 8-9.

[126] *See El Paso Natural Gas Co.*, 25 FERC ¶ 61,149 (1983).

[127] *Pacific Gas Transmission Co.*, 28 FERC ¶ 61,217 (1984), *modified*, 32 FERC ¶ 61,001 (1985).

[128] Moreover, Transwestern's minimum bill recovered variable costs as well as fixed costs until the minimum bill rule took effect on August 1, 1984.

[129] *See El Paso Natural Gas Co.*, 30 FERC ¶ 61,097 (1985).

[130] *See* 32 FERC at pp. 61,036-37.

[131] *Id.* at p. 61,036.

rate case, Docket No. RP85-58.[132] As part of this settlement, El Paso agreed to accept whatever minimum bill we hold reasonable for Transwestern in this case. Thus, when our order issues here, El Paso's minimum bill, as well as Transwestern's, will be eliminated.[133] This history hardly suggests that we have discriminated against Transwestern in terms of minimum bill levels.

If Transwestern is arguing the latter (i.e., the weight to be given Transwestern's contracts with its customers), the argument is without merit. The El Paso settlement was an uncontested settlement of a particular rate case and lasted for only a limited term. The Commission's order approving the settlement established no principle or precedent. Transwestern's contracts with its customers are different: they are very much contested, they are not limited to one rate case, they do not terminate after a limited period, and the resolution of the questions raised concerning them will establish both principles and precedents. Hence we do not see how we have discriminated against Transwestern.

The EOC Companies contend that our decision here is an unprecedented departure from the Commission's past policy of accepting minimum bills. The problem with this contention is that the Commission has never had a general policy of accepting minimum bills. Instead, the Commission has assessed minimum bills in light of the particular facts of the pipeline.[134] That assessment has often led the Commission to accept minimum bills. But is has also led the Commission to

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[132] *El Paso Natural Gas Co.*, 32 FERC ¶ 61,323 (1985).

[133] Under the settlement El Paso has the right to seek a hearing to justify a minimum bill different from the minimum bill we find reasonable for Transwestern. If El Paso exercises this right and if we should agree with El Paso on the merits, our decision would be effective prospectively only.

[134] *Atlantic Seaboard Corp.*, 38 FPC at 95.

reject proposed minimum bills,[135] modify existing minimum bills,[136] and reject existing minimum bills.[137] Hence for the EOC Companies' argument to succeed, it must be shown that our assessment of the facts here is inconsistent with either the Commission's assessment of similar facts presented by other pipelines or, more particularly, the Commission's assessment of the facts presented by Transwestern at the time its minimum bill was initially accepted. The EOC Companies have not seriously attempted to show the first.[138]

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[135] *Id.*

[136] *Tennessee Gas Transmission Co.*, 11 FPC 685 (1952).

[137] *Southern Natural Gas Co.*, 56 FPC 677 (1976).

[138] All the EOC Companies have done is to point to several cases. None merits but brief attention. One case cited is *Texas Gas Transmission Corp.*, 24 FERC ¶ 61,049 (1983). But in this case the Commission simply approved an uncontested settlement. Such approval does not, as the Commission noted, constitute "approval of or precedent regarding any principle or issue in the proceeding." Another case the EOC Companies cite is *United Gas Pipe Line Co.*, 25 FERC ¶ 61,088 (1983). But the Commission's approval of the minimum bill in that case was vacated and remanded because of insufficient evidence showing that a minimum bill was needed to remedy one of the problems identified in the *Atlantic Seaboard* case. The case is still before us. Accordingly, we will not opine on that case here. Finally, the EOC Companies point out that in a number of cases involving electric utilities the Commission has approved demand ratchets for partial requirements customers. The EOC Companies argue that demand ratches function like the minimum bill at issue here. We disagree. The way rates are designed for electric utilities and pipelines are vastly different. First, the demand charge for electric utilities generally recovers all fixed costs, *see, e.g., Minnesota Power & Light Co.*, Opinion No. 12, 3 FERC ¶ 61,045, at pp. 61,141-42 (1978); the demand charge for Transwestern does not. Second, the demand charge billing determinants for an electric utility are generally the customer's peak usage in the month; the billing determinant for Transwestern's demand charge is the customer's unvarying contract demand. Thus, without a demand ratched an electric utility might not recover any of the fixed costs allocated to a partial requirements customer. This is not a problem for Transwestern. Hence we do not see the relevance of the demand ratchet

And they cannot show the second. The facts that caused the Commission to accept a minimum bill for Transwestern in 1959 no longer exist. As we pointed out in Opinion No. 238, the Commission accepted Transwestern's minimum bill for sales to Pacific to provide Transwestern with an assured market so that it could issue the bonds necessary to construct its pipeline.[139] The bondholders needed this assurance because Transwestern was proposing to enter a market where the dominant seller, El Paso, had advantages in terms of both fixed costs and gas costs.[140] Thus, giving Transwestern this "helping hand" to compete against El Paso, was justified because it enabled a new competitor to enter the market and thereby increased competition. But now the "helping hand" the minimum bill gives is no longer necessary. Transwestern is an established pipeline, its bonds have been retired, and the advantages El Paso had no longer exist.[141] Since restraints on the opportunity of customers to

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cases to this case. *See also Mississippi River Transmission Corp.*, 759 F.2d at 956 n. 15.

[139] 32 FERC at p. 61,033.

[140] El Paso's advantage in terms of fixed costs stemmed from the fact that a pipeline's fixed costs decline as its rate base is depreciated. Hence a pipeline like El Paso that has been in business for some time will have lower fixed costs, all other things being equal, than a new pipeline like Transwestern. This phenomenon is sometimes called the "front-end load problem." It is succinctly discussed in *Farmers Union Central Exchange* v. *F.E.R.C.*, 734 F.2d 1489, 1516, n. 64 (D.C. Cir.), *cert. denied,* 105 S. Ct 507 (1984).

[141] Opinion No. 238, 32 FERC at p. 61,033. Transwestern disputes one minor aspect of this finding as it applies to gas costs. In Opinion No. 238 we noted that in 1959 Transwestern's commodity rate was 40 percent higher than El Paso's and that at the time of the hearing it was 3.6 percent higher. We also noted that as a result of Transwestern's and El Paso's October 1984 PGA filings, Transwestern's commodity rate was lower than El Paso's. *Id.* Transwestern argues that our reliance on the October 1984 PGA filings is misplaced because it represents a "snapshot" view of its rates. Applications for Rehearing for

buy from competitors, such as minimum bills, can be justified only so long as they are necessary to accomplish some legitimate objective,[142] there is no inconsistency between the Commission's decision in 1959 to accept Transwestern's minimum bill and our decision here.

Transwestern argues that, because new competitors have entered the southern California market, it still needs the "helping hand" a minimum bill provides to compete.[143] We disagree. The Commission accepted Transwestern's minimum bill in 1959 as a means of increasing competition in the southern California market. We think that was appropriate. But we see nothing in the Commission's 1959 decision or in any other decision that suggests established pipelines like Transwestern are to be protected against the entry of new competitors. Indeed, any such suggestion would be at war with the premises of both the antitrust laws and the Natural Gas Act.[144]

Finally, Transwestern argues that we erred in Opinion 238 by denying its motion to reopen the record to reflect changes that have occurred since the record was closed.[145] We disagree. In Opinion No. 238 we did not find "good cause" to reopen the record. We still do not find "good cause." We write here only because on further reflection we see less in Transwestern's arguments than we originally thought was there.

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Transwestern, at 14. The problem with this argument is that since October 1984 both companies have made several PGA filings. The commodity rates these filings establish for Transwestern have been consistently lower than the rates for El Paso.

[142] *See, e.g.,* Areeda and Turner, Antitrust Law ¶ 732c4.

[143] Application for Rehearing for Transwestern, at 18. Transwestern there mentions the Port Arguello project.

[144] *See, e.g., Northern Natural Gas Co.* v. *F.P.C.,* 399 F.2d 953, 968-70 (D.C. Cir. 1968) and the cases cited therein.

[145] 32 FERC at pp. 61,037-38.

One change Transwestern points to as requiring us to reopen the record is a change in the CPUC's purchasing policy. Transwestern's point here is that under the CPUC's new policy purchases within minimum bill levels are sequenced ahead of other purchases of gas.[146] Hence, Transwestern argues, it now needs a minimum bill to compete in the southern California market. The problem with this argument is that, while there have been changes in the CPUC's purchasing policy, the treatment of purchases within minimum bill levels is not one of them. The CPUC's purchasing policy in effect at the time of the hearing and discussed at length on the record also provided that purchases within minimum bill levels would be sequenced ahead of other purchases.[147] Hence we do not see here a change in circumstances that requires us to reopen the record.

A second change Transwestern mentions is that after the close of the record the Commission allowed Northwest Alaskan Pipeline Company to impose on Pacific Interstate Transmission Company, and through it, SoCal, a 60 percent minimum purchase obligation.[148] This is true. But at the time of the hearing Northwest Alaskan imposed on Pacific Interstate, and through it, SoCal, a 78 percent minimum purchase obligation.[149] Thus, the only change that has occurred since the record closed is a reduction in Pacific Interstate's, and consequently, SoCal's obligation to Northwest Alaskan. This hardly amounts to a change in the core circumstances that goes to the heart of the case. Because

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[146] *See* Transwestern's Motion to Reopen, filed May 31, 1985, at p. 6-9.

[147] *See, e.g.,* Exh. 53, pp. 5-6.

[148] *Northwest Alaskan Pipeline Co.,* 29 FERC ¶ 61,304 (1984).

[149] *See* Exh. 51, pp. 4-6; Exh. 55, p. 13.

that is so, this change does not warrant reopening the record.[150]

Transwestern also argues that the record needs to be reopened because it does not contain any evidence on the effects of the Commission's minimum bill rule, which excluded variable costs from the operation of all minimum bills and eliminated minimum take obligations. We disagree. To be sure, the minimum bill rule was issued after the record in this case closed. But all the minimum bill rule did was to grant on an industry-wide basis some of the relief sought by several of the parties in this case. Hence Transwestern had the opportunity to develop a record on the likely effects of excluding variable costs from its minimum bill and eliminating its minimum take obligation. Accordingly we see no need to reopen the record for this reason.[151]

Another change Transwestern mentions is that after the effective date of the minimum bill rule Northwest Central significantly reduced its purchases from Transwestern. This conduct is different from the representations Northwest Central made at the hearing.[152] But in Opinion No. 238 we did not rely on these representations. Hence this change is also one that does not go to the heart of the case.

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[150] *See Trans-Andarko Pipeline System*, 26 FERC ¶ 61,202 (1984), *citing Air Products & Chemicals, Inc.* v. *F.E.R.C.*, 650 F.2d 685 (5th Cir. 1981).

[151] In its motion to reopen the record Transwestern points out that the judge stated that, because the minimum bill rule was issued after the close of the record, the effect of excluding variable costs from the minimum bill on the customers buying patterns was uncertain. 29 FERC at p. 65,162. But this does not help Transwestern's argument. The judge made this statement in the context of his discussion of the arguments that Transwestern would or would not incur take-or-pay liability if its minimum bills were modified or eliminated. *See* Opinion No. 238, 32 FERC at p. 61,032. As we noted there, these arguments are irrelevant.

[152] *See, e.g.*, Exh. 69, p. 5.

Another change Transwestern mentions is that, if it makes no sales to Northwest Central, substantial fixed costs will be reallocated to Pacific, thereby adversely affecting Transwestern's ability to compete in the southern California market. The problem with this argument is that it assumes costs will be reallocated in a subsequent rate case to such an extent that Transwestern's rate will not be competitive. But Transwestern has filed the subsequent rate case, and the resulting rates for sales to Pacific are lower than Transwestern's major competitor, El Paso. Hence we see no need to reopen the record to consider this possibility.

The final change Transwestern mentions is the Commission's rulemaking in Docket No. RM85-1, *Regulation of Natural Gas Pipelines After Partial Well-Head Decontrol,* which resulted in the issuance of Order No. 436, *et seq.*[153] Among other things, Order No. 436 established the regulations under which pipelines may engage in self-implementing transportation. Both Transwestern and El Paso have indicated that they will engage in self-implementing transportation. Their doing so may result in a substantial restructuring of the southern California market. But we will not know until both pipelines have engaged in self-implementing transportation under Order No. 436 for some time. Hence the effect of the Commission's rulemaking on Transwestern's position in the southern California market is speculative at this time. Since that is so, reopening the record is not warranted.[154]

## V.

We have considered other arguments raised in the applications for rehearing. But we see nothing in them that requires

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[153] 50 Fed. Reg. 42,408 (1985).

[154] *Energy Terminal Services Corp.*, 20 FERC ¶61,053, at p. 61,112.

a change in Opinion No. 238 or warrants further discussion. Accordingly, the applications for rehearing filed by Transwestern, El Paso, and the EOC Companies must be, and hereby, are denied.

# APPENDIX E

## ALJ Decisions and Reports

**[¶63,054]**
**Transwestern Pipeline Company**
**Docket No. RP81-130-007**
**Initial Decision of the Administrative Law Judge**
**(Issued December 11, 1984)**

**George P. Lewnes, Presiding Administrative Law Judge.**

### Appearances

*James W. McCartney, Judy M. Johnson, David T. Andril* and *Richard T. Kruse* for Transwestern Pipeline Company

*Michael D. Gayda, E. R. Island, John H. Craig III, Glen J. Sullivan* and *T. D. Clarke* for Pacific Interstate Transmission Company, Pacific Offshore Pipeline Company, Southern California Gas Company and Pacific Lighting Gas Supply Company

*Randolph W. Deutsch, Lawrence Q. Garcia, J. Calvin Simpson, Janice Kerr, Michael B. Day* and *William R. Stalder* for Public Utilities Commission of the State of California

*Kim M. Clark, William J. Grealis, Rush Moody, Seth Molay, William J. Sears* and *John B. Rudolph* for Northwest Central Pipeline Corporation

*Margaret Sullivan, Peggy Kobacker Shiffrin, Philip J. Mause, Norman A. Pederson, Roger B. Coven* and *Barton M. Myerson* for San Diego Gas & Electric Company

*Larry R. Cope, H. R. Barnes* and *Susan L. Steinhauser* for Southern California Edison Company

*Daniel P. Selmi, Douglas B. Noble* and *Emil Stipanovich* for the Governor and the Attorney General of the State of California

*Edward C. McMurtrie, William W. Bedwell, Dale A. Wright* and *Gregory Grady* for Southwest Gas Corporation

*Richard C. Green, C. Frank Reifsnyder, Donald J. MacIver, Richard Owen Baish* and *Scott D. Fobes* for El Paso Natural Gas Company

*Cameron R. Graham* and *Philip W. Jordan* for Western Gas Interstate Company

*Daniel J. Wright, Edward M. Leigh* and *Herbert Zinn* for Arizona Public Service Company

*Harry Cowger* and *C. Edward Peterson* for Kansas Corporation Commission

*Phillip G. Lookadoo* and *Ted P. Gerarden* for Gas Service Company

*John R. Staffier, George W. McHenry, Jr.*, and *John H. Burns, Jr.* for Pan-Alberta Gas, Ltd., and Foothills Pipe Lines (Yukon) Ltd.

*Robert J. Haggerty, Robert A. Rima, Cameron R. Graham* and *Philip W. Jordan* for Southern Union Gas Company of New Mexico

*Sue Ann Schiff* and *Merek E. Lipson* for Pacific Gas Transmission Company and Pacific Gas and Electric Company

*Peter W. Hanschen* and *Robert B. McLennan* for Pacific Gas and Electric Company

*Carl W. Ulrich* for Phelps Dodge Corporation

*Jeffrey G. Di Sciullo, Cuba Wadlington, Jr.* and *Donald C. Shepler* for Northwest Alaskan Pipeline Company and Northwest Pipeline Corporation

*Arnold D. Berkeley* for Arizona Electric Power Cooperative, Inc. and City of Willcox, Arizona

*J. Michel Marcoux* and *William W. Royer* for El Paso Electric Company

*Randall S. Rich* and *Robert W. Gee* for the Staff of the Federal Energy Regulatory Commission

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**Procedural History**

On February 28, 1983, Transwestern Pipeline Company (Transwestern) submitted a Stipulation and Agreement in settlement of certain issues in Transwestern's Docket Nos. RP81-130, TA82-2-42 and TA83-1-42. More specifically, the agreement resolved all issues in Docket No. RP81-130 except (1) those issues pertaining to Transwestern's minimum billing provisions in its rate schedules for service to Pacific Lighting Gas Supply Company (PLGS) and

Northwest Central Pipeline Corporation (Northwest Central) and (2) related cost classification, allocation and rate design issues. Resolution of these issues after trial, would be applied prospectively from the date of a final Commission order. In addition, the agreement also reserved for hearing the issue arising from Docket Nos. TA82-2-42 and TA83-1-42 of the prudency of Transwestern's gas purchase practices. On March 23, 1983, the proposed uncontested offer of settlement was certified to the Commission by the Presiding Judge. By letter order of May 2, 1983, the Commission approved the agreement. 23 FERC ¶ 61,209.

Since the Presiding Judge in the instant proceeding was also designated to preside in the proceeding regarding the alleged disparity of Transwestern's purchase and sales estimates in Docket Nos. TA82-2-42 and TA83-1-42, joint hearing were commenced on June 28, 1983, as to this issue and as to all of the other issues reserved for hearing in accordance with the above-mentioned settlement. After five weeks of hearings, the record was closed on July 29, 1983, and initial and reply briefs were filed on September 26, 1983, and on October 31, 1983, respectively. However, on December 6, 1983, the Chief Administrative Law Judge acting under delegated authority of the Commission, issued an order severing the minimum bill and related rate design issues from this proceeding and consolidating them in the proceedings in Pacific Gas Transmission Company, *et al.*, Docket Nos. RP83-113-000, *et al.*[1] On January 10, 1984, the

[1] The consolidated proceedings involved the following companies: Pacific Gas Transmission Company, Docket No. P83-113, Pacific Interstate Transmission Company, Docket No. RP83-135, Pacific Offshore Production Company, Docket No. RP83-136, Pacific Interstate Offshore Company, Docket No. RP84-28, El Paso Natural Gas Company, Docket No. RP83-139 and Transwestern Pipeline Company, Docket No. RP81-130.

Presiding Judge issued an Initial Decision (Phase I)[2] disposing of all issues referred to above except for the minimum bill and related rate design issues in Docket No. RP81-130.[3] 26 FERC ¶ 63,008. The record certified to the Commission at that time consisted of 27 volumes of transcript (3844 pages), 169 exhibits and 16 items by reference admitted in evidence.[4] On May 16, 1984, the Commission issued an order affirming the Initial Decision. 27 FERC ¶ 61,255. Rehearing was denied by order dated August 10, 1984. 28 FERC ¶ 61,209.

Although the issues of Transwestern's minimum bill provisions and related rate design were also the subject of the above-described evidentiary hearings, they were now to be pursued further in the consolidated proceedings in Docket No. RP83-113, *et al.*, within the context of an overview of the minimum bills of all natural gas suppliers to the California market. A formal prehearing conference was convened on October 26, 1983, followed by formal settlement conferences on May 22, June 7 and June 25, 1984. We need not at this point, laboriously detail the innumerable filings and rulings of the Presiding Judge. It should suffice to state

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[2] An errata to the Initial Decision was issued on January 10, 1984.

[3] On December 30, 1982, the Commission consolidated Transwestern's general rate increase filing in Docket No. RP83-25-000 with the proceedings in Docket No. RP81-130-000, *et al.*, 21 FERC ¶ 61,397. So as not to disrupt the established procedures in the latter dockets, the Presiding Judge designated the hearings to be held in Docket No. RP83-25 as Phase II of the consolidated proceedings. On May 15, 1984, the Presiding Judge certified to the Commission an uncontested offer of settlement in Docket No. RP83-25 disposing of all issues in Phase II (27 FERC ¶ 63,050) which was accepted and approved by the Commission on July 3, 1984. 28 FERC ¶ 61,099.

[4] The following documents were identified but were not admitted in evidence. Exhibits 30, 45, 47, 127, 145, 148, 166 and Item I. Exhibits 45 Revised and 47 Revised were admitted in evidence.

that settlement negotiations were terminated and procedural schedules were established that contemplated the commencement of hearings on December 3, 1984, if not sooner, depending on the Presiding Judge's schedule of other cases. On August 17, 1984, the Commission issued an order in Docket No. RP83-113, *et al.*, severing the minimum bill and related rate design issues in Docket No. RP81-130 "for separate decision on an expedited basis based on the existing record in that docket." 28 FERC ¶ 61,217.

On October 4, 1984 [29 FERC ¶ 63,011], the Presiding Judge certified to the Commission a contested offer of settlement filed by Transwestern and Northwest Central which, if approved, would conclude the instant proceeding as between them. Similarly, on October 22, 1984 [29 FERC ¶ 63,022], a unilateral offer of settlement filed by Transwestern and opposed by PLGS and the Staff was certified to the Commission. This offer seeks to conclude the proceeding as between Transwestern and PLGS. Both offers of settlement are currently pending before the Commission.

Two final comments. Firstly, the record upon which this Initial Decision is based, as noted above, is before the Commission on the previous certification with the Phase I Initial Decision in Docket No. RP81-130. The only additional matter of record now being certified to the Commission are the four volumes of transcript (pages 1 - 234) encompassing the conferences held in Docket No. RP83-113, *et al.* and two items by reference, *infra,* at 27.

Secondly, the appearances listed in this Initial Decision reflect the combined on-the-record appearances in the unconsolidated Docket RP81-130 proceeding and the consolidated Docket No. RP83-113, *et al.*, proceedings. The Presiding Judge is aware that some of those appearances may be based on petitions to intervene in the latter proceedings that may not have set forth any direct interest in the

issues presented in Transwestern's Docket No. RP81-130 in isolation. So as to avoid controversy before the Commission, parties filing briefs on exceptions to this Initial Decision, who had not intervened in the unconsolidated Docket No. RP81-130 proceeding, are requested to set forth in their exceptions that part of their intervention petition in the Docket No. RP83-113, *et al.*, proceedings relied upon to support a contention that they are indeed a party in interest in Docket No. RP81-130.

**Historical Background**

In 1958 Transwestern filed an application in Docket No. G-14871 for a certificate of public convenience and necessity under Section 7 of the Natural Gas Act (Act) authorizing it to construct and operate a natural gas pipeline system to be constructed from the Panhandle-Hugoton area of Texas and Oklahoma, and the Permian Basin area of Texas and New Mexico, to a terminus on the California-Arizona border near Topock, Arizona, and to sell and deliver stated quantities of natural gas at that point to PLGS for resale in Southern California through the latter's affiliated distribution companies. That application was consolidated for hearing with approximately 23 natural gas producer applications which constituted Transwestern's contracted gas supply for the project.

After extensive hearings, the presiding judge issued an initial decision on July 1, 1959, recommending authorization of the project with an initial delivery obligation of 300,000 Mcf per day and an expansibility, when fully powered, to 640,000 Mcf per day. 22 FPC 407. In doing so, the trier of fact noted that El Paso Natural Gas Company (El Paso) was currently serving the same market but that the market was suffering from a "diminishing supply of natural gas" (*Id.* at 409) and that "quantities of natural gas are

urgently required to meet the heavy actual and anticipated growth in peak-day firm demand experienced in this market area, also that in the very near future the Gas Supply Company (PLGS), and its affiliated companies, the Southern California Companies, will require additional quantities." *Id.* at 413. The presiding judge also observed that the "record clearly indicates the delivered price of the Transwestern gas, even though the delivered price decreases as the volume increases, is higher than the Gas Supply Company is presently paying for out of state natural gas." *Id.* at 414. In this regard, he found that the "record further shows it was the desire of Transwestern to purchase the gas for the Gas Supply Company, and ultimately for the Southern California consumer, as cheaply as it could." *Id.* at 416.

Turning to Transwestern's proposed financing for the project, the presiding judge stated that Transwestern had arranged to sell $142,000,000 mortgage bonds "privately to institutional investors on approximately a 5 percent basis and the total bond issue is to be retired by the end of the 20th year." *Id.* at 417. The feasibility of financing the project was attested to by a partner of Lehman Brothers "based upon Transwestern's ultimate pipeline capacity, its present and potential gas supply and reserves and the urgent need for the gas in the Southern California market." *Id.* Finally, the presiding judge noted that the *Seaboard*[5] rate design had been utilized by Transwestern (*Id.* at 414) and that the final agreement between Transwestern and PLGS provides "for the full 100 percent take-or-pay-for on the part of the Gas Supply Company. This feature of the agreement is especially important to Transwestern since they will have only the one customer, the Gas Supply Company." *Id.* at 412.

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[5] *Atlantic Seaboard Corporation, et al.*, Docket No. G-1384, *et al.*, 11 FPC 43 (1952).

Upon review of exceptions and after oral argument before the Commission, the initial decision was affirmed except for certain modifications and conditions incorporated in the Commission's Opinion No. 328, 22 FPC 391 (1959). First, the Commission observed that the project as proposed "cannot deliver more than 350,000 Mcf per day" although "[i]t may well be that when the system is fully powered, its deliverability will be 640,000 Mcf per day, and that this capacity may be realized with only nominal additions to Transwestern's investment." *Id.* at 394. The Commission also concluded that the "mere fact that a pipeline may have inexpensive expansibility is not of itself adequate justification to depart from the *Seaboard* method." *Id.* It therefore affirmed Transwestern's use of the *Seaboard* classification and rate design.

The Commission then turned its attention to the proposed 100 percent minimum bill with a 10-year make-up period. Observing that the "need for a high minimum bill is apparently caused in part at least by the take-or-pay provisions in Transwestern's gas purchase contracts" (*Id.* at 395) and having concluded that "[s]uch a device in the minimum bill cannot be said to be required by the public convenience and necessity" (*Id.* at 394), the Commission proceeded to condition the certificate authorizations to Transwestern and the producers thusly (*Id.* at 403-405):

> (B) Transwestern, 90 days prior to commencement of service hereunder, shall file a tariff and rate schedules satisfactory to the Commission which shall include . . . (3) a minimum bill consisting of demand charge plus commodity charge for a volume not in excess of 75 percent of the contract demand times number of days in the billing month, and (4) an increase in the commodity component of its rates, if desired, to offset the elimination of the high minimum bill provisions.

> (G) The independent producer applicants shall, as a condition to the certificate herein issued, revise the take-or-pay provisions in their supply contracts with Transwestern to be filed as rate schedules to bring such supply take-or-pay into balance with Transwestern's minimum bill to Gas Supply.

The Commission's rationalization for the inclusion of both of the above conditions in the certificate authorizations was as follows (*Id.* at 395):

> The rationale of our realining the Transwestern minimum bill with the concurrent adjustment in its commodity charge and the realinement of the take-or-pay provisions in Transwestern's supply contracts is basically the requirement that payment be made for services rendered. Ratepayers of Gas Supply ought not to be called upon to supply a constant flow of dollars to Transwestern for a variable supply of gas from it, which dollars Transwestern in turn must pass on to the producers with still more cash supplied by extra-revenue sources.

Upon rehearing of Opinion No. 328, the Commission issued its order on September 23, 1959 (22 FPC 542) wherein it noted Transwestern's objection to Ordering Paragraph (B) requiring it to change the minimum bill to 75 percent rather than the 100 percent minimum bill proposed: "Transwestern contends that it cannot economically or feasibly market its securities with the 75 percent minimum bill provision, but that it could finance its project with a 91 percent minimum bill provision similar to that which El Paso Natural Gas Company has in its tariff for the delivery and sale of natural gas to the same California distribution companies which will receive Transwestern's gas." (*Id.*) The Commission noted, further, that "Transwestern indicates that it would accept a reduction in its minimum bill to 91 percent, and that it would accordingly reduce the contractual

make-up period from ten years to five years so as to make its arrangement compatible with El Paso's." (*Id.*)

In consideration of these arguments the Commission modified Ordering Paragraph (B) of Opinion No. 328 (*Id.* at 543):

> Inasmuch as El Paso has a 91 percent minimum bill for gas which it sells to these same distribution companies, and it appears that a similar provision would protect Transwestern from discrimination in the event of market fluctuations and insure the financing of its project, we shall modify Opinion No. 328 and the accompanying order by requiring a reduction in the proposed minimum bill from 100 percent to 91 percent, instead of to 75 percent, and a substitution of a five year make-up period for the proposed ten year period. In view of this modification, it will be necessary for us to further modify our said opinion and order by eliminating the provision whereby we permit Transwestern to raise the commodity component of its rates to offset the reduction in its high minimum bill.

The Commission also deleted the condition set forth in paragraph (G) of Opinion No. 328 "since the modification of the minimum bill condition from 75 percent to 91 percent, as discussed above, removes the need for a reduction of the take-or-pay provisions in the producers' contracts." (*Id.*) The certificate authorizations, as modified on rehearing, were accepted by the applicants. The monopoly held by El Paso since 1946 as the sole out-of-state supplier of natural gas to the Southern California market ended in 1960 with the certification of Transwestern.

In 1963, consolidated comparative hearings were held regarding proposals filed by El Paso in Docket No. CP64-76, Transwestern in Docket Nos. CP63-204 and CP64-91 and Gulf Pacific Pipeline Company (Gulf Pacific) in Docket No. CP63-223, all of which sought to bring additional supplies of natural gas to Southern California, for the purpose of

determining the most desirable manner of meeting the long-term needs for natural gas in Southern California. Although the trier of fact who presided over those hearings recommended authorization of the Gulf Pacific project in his initial decision issued in 1965 (36 FPC 262), the Commission, on review of exceptions, reversed and granted certificate authorization with certain stated conditions, to the projects of El Paso and Transwestern. Opinion No. 500, 36 FPC 176, *modified,* Opinion No. 500-A, 36 FPC 1010 (1966).

More specifically, Transwestern was authorized to construct facilities necessary to increase the level of Transwestern's deliveries to PLGS by 340,000 Mcf per day to a system design capacity of 640,000 Mcf per day, in phased increments tailored to meet anticipated market requirements. El Paso received a similarly phased expansion authorization of 250,000 Mcf per day. To finance its cost of facilities, Transwestern proposed to issue $36 million of 5¼ percent additional first mortgage bonds. 36 FPC at 282. The 91 percent minimum bill provision in Transwestern's tariff remained unaltered and apparently unmentioned in the initial decision and in Opinion Nos. 500 and 500-A.

In 1965, Transwestern received authorization in Docket No. G-20464, *et al.,* to institute natural gas service to Cities Service Gas Company (Cities), now Northwest Central, Opinion No. 472, 34 FPC 659. More specifically, Transwestern was authorized to sell and deliver to Cities on a firm basis, 50,000 Mcf per day through 1965 and 100,000 Mcf per day thereafter for the remaining years of a twenty-year term from the date of initial delivery. Transwestern proposed to defray the cost of facilities to render the service, estimated at $1,275,700, "from funds made available through company operations and no additional financing will be required." *See* Initial Decision, 34 FPC at 678. The

Commission's order included the following condition (34 FPC 667):

> (1) If there are any deficiencies in Transwestern's revenues during the first six years of operation under the Cities' contract (other than deficiencies resulting from increases in the cost of purchased gas), no such deficiencies will be taken into account in computing Transwestern's cost of service to Pacific Lighting Gas Supply Company, nor shall any such deficiencies be used to support increased rates in any rate increase application by Transwestern directed to Pacific Lighting Gas Supply Company.

Although Transwestern's contract demand rate schedule to PLGS included a 91 percent minimum bill, it appears that the contract demand rate schedules for service by Transwestern to Cities included a 90 percent minimum bill with a five-year make-up.

Transwestern's final expansion for service to the California market was in Docket No. CP68-181. There, Transwestern proposed to construct additional facilities so as to increase firm deliveries to PLGS from a then authorized daily contract volume of 640,000 Mcf per day to a total of 750,000 Mcf per day. The estimated cost of the proposed facilities was $42,410,000 of which approximately $1.3 million was related to another Transwestern proposal for additional service to Cities described below. Financing of the project was to be "by private issue of pipeline mortgage bonds and by the refinancing of certain debentures." 41 FPC 134, 135. By order of February 4, 1969, the Commission authorized the proposal. *Id.*

On March 11, 1970, the Commission issued its Opinion No. 574 wherein Transwestern was authorized, *inter alia*, to construct and operate additional facilities estimated to cost $4,500,000 which would enable it to deliver for sale to Cities

up to 150,000 Mcf per day. 43 FPC 322, 324. The initial decision, relied upon by the Commission in its issuance of Opinion No. 574, made specific reference to the fact that Transwestern's rate schedule for contract demand service to Cities included a 90 percent minimum bill. *Id.* at 350. Lastly, the Commission's order included a condition similar to the one recited earlier in the certification of initial service by Transwestern to Cities. *Id.* at 345-346.

The foregoing is intended to reflect the major applications filed by Transwestern for the institution and continuation of natural gas service to PLGS and Northwest Central. It does not include other applications filed by Transwestern and authorized by the Commission for the construction of facilities, for example, to attach additional gas supplies.

**The Issues**

Under the revised tariff sheets filed by Transwestern in this docketed proceeding, the current effective minimum bill provisions are retained. Presently, the CDQ-1 rate schedule applicable to service by Transwestern to PLGS contains a minimum bill for both monthly and annual periods. The monthly minimum bill is set at the minimum daily take quantity (MDTQ), that is, the amount which PLGS is obligated to physically take per day, multiplied by the number of days in the month, times the commodity rate. PLGS's MDTQ of 600,000 Mcf is equal to 80 percent of PLGS's annual contract quantity (ACQ) of 750,000 Mcf per day. The CDQ-1 annual minimum bill is equal to 91 percent of the ACQ multiplied by the commodity rate.

The CDQ-2 and CDQ-3 rate schedules applicable to service by Transwestern to Northwest Central contain slightly different minimum bill provisions. Unlike the CDQ-1 rate schedule, the CDQ-2 and CDQ-3 rate schedules include an annual minimum bill only and are set at 90 percent rather

than 91 percent of the respective ACQ quantities. The CDQ-2 and CDQ-3 rate schedules also contain ratchet provisions which have the effect of lowering the ACQ under certain circumstances. Although during the course of these proceedings there has been some controversy as to these amounts, it appears that the current ratcheted figures are as follows: 64,936 dth (dry) for CDQ-2 and 101,299 dth (dry) for CDQ-3. (Exh. 67 at 4)

Lastly, Tranwestern's rate filing of August 28, 1981, in the instant docket utilized a *United*[6] cost classification and rate design methodology. In its subsequent rate filing in Docket No. RP83-25, the Commission adopted and suspended until June 1, 1983, Transwestern's primary tariff sheets which also reflected the *United* methodology. However, Transwestern subsequently requested permission to utilize the *Seaboard* methodology in the tariff sheets that were to become effective on June 1, 1983. The Commission granted the request by letter order of July 1, 1983, and Transwestern's currently effective rates reflect the use of *Seaboard.* Since any rate design determination in the instant proceeding will have prospective application only, the *status quo* cost classification and rate design on the Transwestern system is *Seaboard.*

Parties to this proceeding, except for Transwestern, favor a modification of Transwestern's 91 percent minimum bill provision. The suggested proposals range widely from a 60 percent minimum bill to a total elimination of the provision. Some parties also advocate, in conjunction with their respective proposals for reduction or elimination of the minimum bill, a departure from *Seaboard* to a modified fixed-variable rate design proposed by Staff, or some variation

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[6] *United Gas Pipe Line Company,* Opinion No. 671, 50 FPC 1348 (1973), *reh. denied,* 51 FPC 1014 (1974), *aff'd sub nom., Consolidated Gas Supply Corporation* v. *F.P.C.,* 520 F.2d 1176 (D.C. Cir. 1975).

thereof. Others oppose the methodologies utilized to effectuate these rate design proposals.

**Summary of Positions of the Parties**

Simultaneous initial briefs addressing either or both of the issues were filed by Transwestern, El Paso, PLGS, Northwest Central, Staff, San Diego Gas & Electric Company (San Diego), The Gas Service Company (Gas Service), the Public Utilities Commission of the State of California (CPUC), Governor George Deukmejian of the State of California, and by Arizona Public Service Company (APS) and Southwest Gas Corporation (Southwest) jointly. Except for San Diego, and APS/Southwest, all filed reply briefs.

Transwestern, through the testimony of its witnesses H. Wayne Hodge (Exh. 1), John H. Germain (Exh. 10), J. E. Bixby (Exh. 31) and Richard M. Hawkins (Exhs. 32, 35) advocates the continuation of the CDQ-1, CDQ-2 and CDQ-3 minimum bill provisions described above, as well as a continuation of its present *Seaboard* rate design methodology. Transwestern asserts that (1) the present minimum bill provisions are necessary for the pipeline's economic survival and (2) if its minimum bill provisions remain intact, there is no reason for a change in rate design. Transwestern also argues that because they are a product of contractual agreements, the Commission may not now alter the minimum bill provisions. Lastly, Transwestern contends that parties advocating changes in its present minimum bill provisions and rate design methodology have the burden of proof which they have not sustained.

Going to the opposite extreme in advocating the complete elimination of Transwestern's annual and monthly minimum bill provisions is the Staff. Placing its reliance on the testimony of its witnesses Robert E. Scarbrough (Tr. 3366, Exhs. 85, 101, 102) and Roger A. Odisio (Exhs. 95, 97, 98),

Staff contends that Transwestern's minimum bill provisions are unjust, unreasonable and anticompetitive. Relying on the same testimony, Staff also advocates the adoption of a modified fixed-variable (MFV) rate design which would place most of the transmission fixed costs in the demand component of Transwestern's two-part rate, and all variable costs and production fixed costs as well as return on equity and associated income taxes in the commodity component. Under Staff's MFV proposal, Transwestern's demand rate would be allocated based on both a contract demand volume and annual volumetric usage. Staff asserts that its proposed change in rate design and allocation will ameliorate any financial risk to Transwestern resulting from the elimination of its minimum bill provisions. Staff's witness Mr. Scarbrough cautioned that "[e]limination of the minimum commodity bill but retention of the existing method of cost classification, allocation, and rate design would mean that Transwestern's recovery of fixed costs would suddenly be subject to significantly greater risks of underrecovery." (Exh. 85 at 21) Lastly, in opposition to Transwestern's burden of proof assertions, Staff claims (and is supported by other parties) that "it is clear that the burden falls squarely upon Transwestern to justify its rate filings, of which its minimum bill provisions and rate design are integral parts." (I.B. at 6)

The Governor of California, through the testimony of George Lewis Donkin (Exhs. 70, 78), also supports the complete elimination of Transwestern's minimum bill provisions. Like Staff, the Governor contends that Transwestern's minimum bill provisions are anticompetitive, no longer cost-based and cause "unfairness and harm involving all parties in the natural gas chain from producing well to ultimate California consumer." (I.B. at 34) Unlike the Staff,

however, the Governor does not endorse any specified rate design change for Transwestern. (I.B. at 47)

PLGS, through the testimony of its witnesses Marvin J. Douglas (Exh. 45), Lee K. Harrington (Exhs. 51, 53) and W. D. Morningstar (Exh. 54) proposes reducing Transwestern's annual and monthly minimum bills to 35 percent asserting that (1) the current minimum annual bill and minimum monthly demand quantity are anticompetitive, unjust, unreasonable, unduly discriminatory and preferential and (2) the 35 percent proposed by PLGS appropriately reflects Transwestern's share of the Southern California high priority market. According to PLGS' witness Mr. Harrington their proposed 35% minimum bill level was calculated by estimating PLGS' "high priority" (*i.e.* non-alternative fuel capable) market requirements and deducting from this amount contractual commitments to California, Federal Offshore and Canadian producers. The remainder of the high priority market was then divided between El Paso and Transwestern based on their present contract quantities. (Exh. 38 at 14, Tr. 1659; Exh. 43, I.B. at 37-40) In further support of its proposal PLGS states that the 35 percent level will approximate El Paso's stepped-down minimum bill level and will "strike the proper balance" between purchasing flexibility for Transwestern's customers and financial security for Transwestern. (I.B. at 39)

San Diego on brief, and CPUC through the testimony of its witness William R. Ahern (Exh. 82), subscribe to PLGS's assertions and endorse the latter's proposal. In conjunction with the proposed reduction in the minimum bill level to 35 percent, all three also endorse an MFV rate design. CPUC favors Staff's MFV proposal without modification, while PLGS and San Diego advocate a rate design which differs from Staff's only to the extent that they propose placing production fixed costs in the demand component. Other

departures in position between these three parties are as follows: (1) PLGS argues that short-term discretionary gas purchases by Transwestern should not be included in the volumes used to calculate PLGS's minimum bill obligation; (2) San Diego specifically endorses eliminating variable costs from Transwestern's minimum bill; (3) CPUC states that its support for PLGS's proposal "does not constitute opposition to the recommendation of the staff for a zero minimum bill." (I.B. at 3)

Northwest Central, through the testimony of its witness Darrell B. Mackay (Exhs. 67, 68, 69) favors reducing Transwestern's minimum bill to a 50 percent level, asserting that (1) the current minimum bill is unjust, unreasonable and anticompetitive and (2) the 50 percent proposed by Northwest Central will maintain Transwestern as a viable supplier while still allowing Northwest Central to pursue what it terms its "purchase gas target program." According to Mr. Mackay the 50 percent figure was derived by examining Northwest Central's present sources of supply and "adjusting the gas mix to produce a delivered cost of gas that is competitive with No. 6 fuel oil." (Exh. 69 at 2) (R.B. at 14) To the extent that Transwestern incurs take-or-pay charges as a result of Northwest Central's 50 percent purchase level under contracts executed by Transwestern to meet its service obligation to Northwest Central, Northwest Central "acknowledges that rate treatment of the carrying charges on such payments is appropriate for a limited time until Transwestern has the opportunity to readjust its gas supply level to reflect market needs." (I.B. at 28) Northwest Central takes no position as to any proposed change in rate design.

El Paso, through the testimony of its witnesses Charles R. Jack (Exhs. 55, 63, 153), Benjamin Schiffer (Exh. 64) and Kenneth B. Johnston (Exh. 64A), contends that Transwestern's minimum bill provisions are unjust, unreasonable and

unduly discriminatory. El Paso offers what it refers to as its "parity proposal" under which Transwestern's minimum bill level would be reduced to 60 percent. The 60 percent figure was derived by dividing PLGS' "worst case" market demand by the gas available to it from all suppliers. Under the El Paso proposal, all of PLGS' suppliers would have the same level of minimum bill. As explained by its witness Mr. Jack, PLGS's suppliers would compete freely above the 60 percent level proposed by El Paso. However, in the event that demand fell below the "worst-case" demand projection, PLGS and its affiliate Southern California Gas Company (SoCal) would be required to make *pro rata* reductions in their purchases from all of their suppliers. (Exh. 55, at 21-23) Lastly, El Paso favors adoption of a MFV rate design for Transwestern that is similar to that suggested by PLGS.

El Paso's minimum bill proposal is endorsed by APS/Southwest. That endorsement, however, "is predicated upon it also being adopted with respect to the other interstate suppliers to California." (I.B. at 8)

Finally, Gas Service, which purchases about 96 percent of its gas supply from Northwest Central, also asserts that Transwestern's minimum bills are unjust and unreasonable. Through the testimony of its witness Harold W. Steenbergen (Exhs. 65, 66), Gas Service proposes the elimination of variable costs from Transwestern's existing minimum bills. Gas Service also proposes that to the extent Transwestern is able to sell supplies of gas paid for by its customers under the minimum bill provisions, the costs incurred by the customer should be refunded by Transwestern. Gas Service takes no position as to rate design. It should be noted that subsequent to the filing of reply briefs in this proceeding, the Commission issued its Order No. 380 approving changes to 18 C.F.R. § 154 which prohibits the recovery of variable

costs through a pipeline's minimum bill. Gas Service's proposal regarding the elimination of variable costs from recovery under Transwestern's minimum bills is, as of July 31, 1984, the *status quo.*

**Disposition of Preliminary Matters**

Before embarking on a discussion and resolution of the two major issues, two preliminary, subsidiary matters must be disposed of, namely, (1) whether the MDTQ is properly at issue in this proceeding and (2) who has the burden of proof on the minimum bill issue.

*(1) The MDTQ*

As noted earlier, in addition to a minimum bill provision, Transwestern's tariff contains a provision known as the Minimum Daily Take Quantity (MDTQ) whereunder PLGS is required to take from Transwestern no less than 600 MMcf per day, except in circumstances involving lower proportional takes from other out-of-state suppliers. It is Transwestern's position that, whatever the Commission's authority may be to consider and modify the minimum bill provisions, Transwestern's MDTQ "was clearly not a reserved issue, is not the subject of a Section 5 proceeding, and cannot be abrogated or otherwise modified in this case." (I.B. at 41-42)

Transwestern's position fails for several reasons. Firstly, as explained earlier, Transwestern's MDTQ is the basis for the CDQ-1 monthly minimum bill. Clearly, it would be futile to make a determination regarding the level of the annual minimum bill, without also considering the level of the monthly minimum bill. If, for example, PLGS was still subject to a high monthly minimum bill, a lower annual minimum bill would be ineffectual. The two matters are so inextricably interwoven that one could not reasonably

expect an argument for the modification or elimination of the annual minimum billing in Transwestern's service to PLGS without some reference to a modification of the MDTQ which forms the basis for the monthly minimum bill.

Secondly, we have noted earlier that resolution of the issues here would be applied prospectively from the date of a final Commission order. Consequently, there is no Section 4 refund involved. Thirdly, the issue was raised during the hearing and Transwestern has been on notice from the start of these proceedings that the MDTQ was in issue. What remains to be resolved as to this issue and as to the others relates to the question of who bears the burden of proof.

*(2) The Burden of Proof*

Citing *Public Service Commission* v. *F.E.R.C.*, 642 F.2d 1335 (D.C. Cir. 1980), *cert. denied*, 454 U.S. 879 (1981), Transwestern contends that because it advocates no change in its present minimum bill, it does not bear the burden of proof as to this matter. Proponents of a change in Transwestern's minimum bill, however, contend that under the holdings in more recent cases such as *Cities of Batavia* v. *F.E.R.C.*, 672 F.2d 64, (D.C. Cir. 1982), *Laclede Gas Co.* v. *F.E.R.C.*, 670 F.2d 38, (5th Cir. 1982) and *North Penn Gas Co.* v. *F.E.R.C.*, 707 F.2d 763 (3rd Cir. 1983), Transwestern, as the applicant for a rate change must bear the burden of proof with respect to the "integral" parts of its rate, even if it does not advocate a change in those aspects of its rate.

The issue of the appropriate allocation of burden of proof as to a minimum bill provision was explored by the Commission in *Colorado Interstate Gas Co.*, Docket No. RP82-54-000. Initial Decision issued October 18, 1983, 25 FERC ¶ 63,012, *aff'd in relevant part, 27* FERC ¶ 61,315 (1984); *see also* Order Denying Rehearing, 28 FERC ¶ 61,083 (1984). In

that case the presiding judge, as affirmed by the Commission, held that although Colorado Interstate Gas Company (CIG) did not propose a change in its minimum bill, because the minimum bill constituted an "integral part" of its rate, CIG bore the ultimate burden of proof as to the justness and reasonableness of the minimum bill. Parties advocating a change in CIG's minimum bill, however, were assigned the initial burden of presenting evidence as to why the minimum bill was contrary to the strictures of the Act.

At this point, a moment of digression is in order. Burden of proof, within the context of criminal or civil litigation presents a problem with many facets. There is first the question as to which party must bear the burden of proof. Second, there is the question as to what the party having the burden must do to support its burden. Third, there is the question of what are the consequences of a failure to support the burden. Finally, there is the question of the effect of presumptions and *prima facie* proof upon burden of proof.

Inasmuch as the party having the burden of proof is usually the one who asserts that a proposition is so, the rule may also be stated to be that ordinarily, the party having the affirmative of the issue has the burden on that issue. In civil cases, the party having the burden of proof must ordinarily prove the elements of its case by a preponderance of the evidence. Simply stated, this means that the party having the burden of proving certain facts must make it appear more probable than not that those facts existed. Where the defendant has the burden of proof, as upon an affirmative defense, he also is required to prove the defense by a preponderance of the evidence. Restated, burden of proof merely means a party has the burden of seeing that there is sufficient evidentiary proof to sustain the affirmative proposition it is seeking.

The continual interjection of burden of proof arguments in proceedings before this Commission has created a haze as heavy as what was once referred to as Pittsburg pall. In reality, the expression is one of the pumpkin order, that is, round and smooth and well sounding on the outside but hollow on the inside. In a Section 4 proceeding, before proposed rates or practices can be placed into effect without refund, a determination must first be made that they are just and reasonable. Invariably, the pipeline advocating the rates and practices presents evidence seeking to persuade such a finding. On the other hand, in a Section 5 proceeding a determination must first be made that the existing rates or practices are unjust, unreasonable, unduly discriminatory or preferential before imposing other rates or practices found to be just and reasonable. Invariably, the complainant presents evidence seeking to persuade such a finding. In these latter type of proceedings, such a finding is applied prospectively and no refunds by the pipeline are involved.

In both a Section 4 and 5 proceeding it matters not from whence or whom the evidence was derived to arrive at the necessary findings, so long as it is part of the evidentiary record. Are we to reject the use of evidence produced, for example, by an intervenor in opposition to a pipeline's rate filing which, if taken in tandem with the pipeline's evidence, supports a finding of just and reasonableness as to the pipeline's proposed rates merely because the pipeline had the burden of proof? These views were recently affirmed by the Court of Appeals within the context of a Section 205 proceeding under the Federal Power Act, *City of Winnfield* v. *F.E.R.C.*, 744 F.2d 871 (D.C. Cir. 1984):

> The burden of proof under § 205 relates to burden of persuasion (or, more accurately, risk of non-persuasion) rather than burden of production. See 18 CFR § 2.17(e) (1983) (burden of proof to justify new rates referred to as

"risk of non-persuasion"). . . . If evidence is introduced in the proceeding supporting a rate increase, the increase can lawfully be imposed, regardless of the source from which that evidence comes. . . . [Footnote omitted]

In disposing of the issues in this proceeding, both the Commission's dictates in *Colorado Interstate* and those of the Court in *City of Winnfield,* in conjunction with the views expressed above, will be followed, keeping in mind that Transwestern, albeit in reference to other issues decided in Phase I, has freely admitted, on brief, that its minimum bill provisions are an "integral part" of its service and rates to PLGS and Northwest Central. (I.B. at 54, 59)

**Disposition of the Issues**
**Circumstances, then and now**

We have seen during our peregrinations of the historical background leading to the creation of Transwestern, that the Commission took cognizance of certain facts both (1) in its acting as midwife at the birth of Transwestern and (2) in assuring that Transwestern would survive its post-natal pangs. All of the parties seemingly agree that a pregnant comparison of those facts with extant conditions is a necessary starting point for a resolution of the minimum bill issues. We do so now.

Two salient facts were relied upon by the Commission in concluding that the present or future public convenience and necessity warranted the certification of Transwestern under Section 7 of the Act, as an interstate natural gas pipeline supplier to the Southern California market. Firstly, even though El Paso was then delivering natural gas into that market, there was, nonetheless, an urgent need for additional quantities of gas "to meet the heavy actual and anticipated growth in peak-day firm demand." 22 FPC at 413. Secondly, that because of this shortage of supply in the Southern

California market, Transwestern could market its gas even though the delivered price was higher than the delivered price of El Paso's gas. Currently, the first factor no longer prevails while the second does, that is, there is no gas supply shortage in that market and Transwestern's delivered price is still higher than El Paso's. (Exh. 55 at 14)

Having rejected the 100 percent annual minimum commodity bill proposed by Transwestern and replaced it with a 75 percent minimum bill, the Commission granted Transwestern a certificate for authority to construct and operate the facilities proposed and to render certain sales to PLGS, as more fully discussed earlier. Opinion No. 328, *supra.* However, Transwestern filed for rehearing arguing that it could not successfully market the securities necessary to finance the project with only a 75 percent minimum bill, but it could do so "with a 91 percent minimum bill provision similar to that which El Paso Natural Gas has in its tariff for delivery and sale of natural gas to the same California distribution companies which will receive Transwestern's gas." 22 FPC at 542. In its order on rehearing, the Commission granted Transwestern's request. Noting that Transwestern had but one customer, the Commission went on to justify its action on the basis that "El Paso has a 91 percent minimum bill for gas which it sells to these same distribution companies, and it appears that a similar provision would protect Transwestern from discrimination in the event of market fluctuations and insure the financing of the project." *Id.* at 543.

Currently, all three factors recited by the Commission in justification of interposing a 91 percent minimum bill as requested by Transwestern on rehearing no longer prevail. Transwestern now has two major customers instead of one, the securities necessary to finance the project initially certificated for the commencement of service to PLGS have been

retired (Exh. 38 at 8) and lastly, El Paso no longer has a 91 percent minimum bill. El Paso's currently effective minimum bill of 75 percent of the fixed cost component of its commodity charge has been replaced with a 60 percent minimum bill as per a settlement, provided El Paso accepts the Commission's conditions imposed therein. *See* Order of August 17, 1984, *Pacific Gas Transmission Co., et al.,* Docket Nos. RP83-113, *et al., supra,* 28 FERC ¶ 61,217; *reh. granted* for further consideration, October 15, 1984.

What reasonable conclusions can be drawn from the foregoing as impacting on the minimum bill issues now before us? Because the 91 percent minimum bill provision was part of the certification instituting service to PLGS (and a 90 percent minimum bill provision is contained in its subsequent authorization with Northwest Central), Transwestern would have that tariff provision viewed as an inviolate usufruct for life. Parties to this proceeding correctly dispute this irrationality.

Where the Commission has found that the grant of a certificate under Section 7 of the Act for the initial construction of an interstate natural gas pipeline is or will be required by the present or future public convenience and necessity it has, from time-to-time, imposed conditions in the certificate necessary for, among other things, the implementation and effectuation of that authorization, all pursuant to the following part of Section 7(e) of the Act, as amended, 15 U.S.C. § 717f(e):

> The Commission shall have the power to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as the public convenience and necessity may require.

The Commission has considered as proper, and indeed has interjected, rate considerations and rate conditions in

the certification of projects under Section 7 be they for (1) the initial construction of a pipeline system or (2) the instituting of new service from an existing pipeline system where additional facilities are necessary for commencement of the new service. This was aptly expressed in an order of the Commission involving competitive certificate applications in *El Paso Natural Gas Co., et al.,* Docket No. G-16235, *et al.,* Order Reversing Rulings of Presiding Examiner, issued November 2, 1961, 26 FPC 687, 688.

> Proposed rates are intimately connected with economic feasibility and are necessarily involved in arriving at a determination as to economic feasibility. We must avoid drawing such a rigid limitation on inquiry into rates as will preclude necessary exploration of economic feasibility. Just how far examination into rates should be allowed in a certificate proceeding depends upon a careful weighing of all relevant circumstances and cannot be stated as a definitive rule applicable in all circumstances without modification.

That the Commission has imposed rate conditions under the above-stated circumstances is obvious from the previous review of Transwestern's authorization to institute service to Northwest Central. Recall that a rate condition applicable to the first six years of operation was imposed to protect PLGS, in any figure rate proceeding brought within those six years, from any revenue deficiencies incurred by Transwestern from its certificated service to Northwest Central.

The minimum bill provision interposed at Transwestern's request in the authorization for the construction of facilities and the rendition of service to PLGS on rehearing of Opinion No. 328, can only be viewed as a developmental rate condition to assure, not the economic feasibility, but rather the economic financiability of the project. Developmental rates and rate conditions authorized by the Commission

during initial certifications usually apply to specific volumes of gas over a stated number of years, *e.g.*, Transwestern's initial service to Northwest Central. The developmental rate condition included in the Transwestern certification of initial service to PLGS, at best, was applicable for the term of the securities underlying the financing of the project. As noted above, those securities have been retired and nothing has been disclosed in any subsequent certificates of public convenience and necessity received by Transwestern extending the developmental rate condition beyond that term. We have also seen that the other major condition precedent for the inclusion of the rate condition, that is, an existing 91 percent minimum bill in El Paso's tariff for service to the same market, has also dissipated. What then is the evidence, if any, as would compel a finding that Transwestern's minimum bill provisions, including the MDTQ, should be perpetuated as Transwestern would have it, in perpetuity?

Transwestern's major argument on this issue is that the annual minimum bill and the MDTQ that forms the basis for the monthly minimum bill, were set by contract and as a consequence a "higher standard" of proof under the *Mobile-Sierra*[7] doctrine must be met by a customer in seeking to alter such provisions. Absent a showing that the contract is so onerous that the customer's financial ability to continue service is impaired, Transwestern contends, the customer is not entitled to relief from the contract. (Transwestern I.B. at 55-56) PLGS, on the other hand, contends that it did not contract for the 91 percent minimum bill but rather acquiesced in it after the Commission in Opinion No. 328 had rejected the 100 percent minimum bill proposed by Transwestern at that time. Both PLGS and the Staff, among

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[7] *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956); *F.P.C.* v. *Sierra Pacific Power Co.*, 350 U.S. 348 (1956).

others, argue that Transwestern misinterprets and misapplies *Mobile-Sierra.*

We need not resolve the dispute as to whether PLGS did contractually agree to a 91 percent minimum bill. Nor need we engage in a dissertation on the subject of the *Mobile-Sierra* doctrine, except to parenthetically note that Transwestern's interpretation and application of that doctrine is so new that one doubts if it will ever become old. Neither discussion is critical to the disposition to be made here.

What the Commission giveth in a tariff it can taketh away, and contract provisions are not controlling so long as the Commission makes the requisite statutory findings. For example, during its regulation of natural gas producers in the 1950-1960's period, the Commission refused to allow in its certification of sales by producers to pipelines, contract rates that were in excess of Commission mandated public interest "in-line prices." And it is not past present recall that the Commission refused to recognize the validity of favored nation clauses in producer contracts underlying certificates of gas sales to pipelines, and in fact outlawed same. In the instant case, the Commission refused to accept the tendered 100 percent minimum bill and eventually accepted the 91 percent minimum bill under a given set of circumstances or scenario. Transwestern was on notice that once that scenario changed or the underlying premises were satisfied, the Commission could revert to its former holdings in its rejection of the initially proposed 100 percent minimum bill, or any other just and reasonable alternative.

Based on the foregoing discussion, it is concluded that the record is devoid of any substantial evidence as would sustain a finding that Transwestern's current minimum bill provisions are just and reasonable. But is there evidence to support a finding that those provisions are unjust, unreasonable, unduly discriminatory, or preferential? In making that

inquiry, we need not sustain a finding as to each of the four ingredients since one poison arrow is fatal enough.

Perhaps the most egregious feature of Transwestern's minimum bill provisions is that they are unduly discriminatory as to PLGS and preferential as to Northwest Central. The record clearly establishes that PLGS and Northwest Central are similarly situated customers. Both receive firm contract service from Transwestern and both are partial requirements customers of Transwestern, yet their respective minimum bills vary significantly in their relative economic impact. Unlike the minimum bill provisions applicable to PLGS, Northwest Central's minimum bill provisions (1) contains no monthly bills and no minimum daily take requirements (MDTQ) and (2) do contain provisions for the downward adjustment in the annual CDQ in the service agreements between Transwestern and Northwest Central. (Exh. 10 at 11, Exh. 85 at 41, 91, Tr. 3555)

In addition, Northwest Central's minimum bills are set at 90 percent of CDQ times the number of days in the year while the minimum bill of PLGS is set at 91 percent of ACQ or the amount tendered if it is less than 91 percent of ACQ. Because of the downward ratcheting provisions of at least the CDQ-2 rate schedule applicable to Northwest Central, the effective minimum bill to Northwest Central is significantly less than 90 percent of contract demand, arguably as low as 59 percent. (Tr. 3183) Moreover, Transwestern's reduction in Northwest Central's minimum bill quantities may free up more gas for sale to PLGS, thereby raising PLGS's minimum bill if, as a result, Transwestern can tender 91 percent or more ACQ. (Tr. 3392-94)

We have previously discussed and discarded Transwestern's claims in support of its annual minimum bill. Its apparent sole support for the MDTQ provision, applicable to PLGS only, is that it effectively protects Transwestern

from "swings" by PLGS, particularly since Transwestern has no storage capacity. However, Transwestern's witness Mr. Germain testified that (1) Northwest Central does not have an MDTQ in its contract with Transwestern, (2) Northwest Central has "swung" on Transwestern in the past varying its takes from day to day and (3) Transwestern was able to absorb those "swings". (Tr. 1533-34) He stated that because of the magnitude of Transwestern's contract with PLGS, the potential swings there could not be absorbed by Transwestern because of take-or-pay provisions with producer suppliers. (Tr. 1534) This assertion is not supported by, and is contrary to, the evidence of record.

Staff's witness Mr. Scarborough and PLGS's witness Mr. Harrington on rebuttal, reached acutely into the minimum bill muddlement and brought forth the simple, uncontroverted facts which discredit all assertions supportive of the MDTQ. First, we quote Mr. Scarborough (Exh. 102 at 2-3):

> Q. Mr. Germain argues that MDTQ is essential for a pipeline like Transwestern which has no storage capacity. Do you agree?
>
> A. I can certainly appreciate the fact that a new pipeline company, without storage and with only one customer, like Transwestern when it was first certified to serve Pacific, would want some assurance that the customer's daily takes would meet the pipeline's purchase obligations from producers. This is because a failure to market its purchases could lead to take-or-pay obligations. However, under current circumstances there are several reasons why MDTQs are not essential. First, Transwestern indicates in a data response (Staff Data Request - BAW-3) that 30% of its purchases have been from short-term, interruptible supplies which do not contain take-or-pay provisions. It further states that the majority of contracts for long-term sources contain provisions which require Transwestern to purchase 80% of gas well gas and/or all casinghead gas. Transwestern

> estimates that because of certain operational difficulties, a maximum overall reduction of 10% would be possible. Based on this data supplied by Transwestern, it appears that Transwestern could reduce its take by approximately 40% with no take-or-pay consequences.

Mr. Scarborough went on to note that although Northwest Central's purchases represent approximately 25 percent of Transwestern's historical market, Transwestern did not impose an MDTQ on Northwest Central. "If, as Mr. Germain suggests, a MDTQ is essential, then I fail to understand the lack of a MDTQ on such a significant share of its market." (*Id.* at 3-4) He concluded thusly (*Id.*):

> Finally, other pipeline companies, faced with declining markets, are taking actions other than relying on MDTQ's. For example, other companies are attempting to negotiate better take-or-pay provisions with their producers. In my opinion, the facts that (1) 30% of Transwestern's supply is interruptible; (2) 10% to 20% of long-term supplies may be interrupted without take-or-pay consequences; (3) Pacific is not Transwestern's total market, and (4) other pipelines are attempting to negotiate more favorable take-or-pay terms indicate that the MDTQ is not essential.

Mr. Harrington testified thusly (Exh. 53 at 5-6):

> Q. What is PLGS's position regarding the relationship of the minimum bill to the minimum daily take quantity or MDTQ which Mr. Germain discusses at pages 8 and 9 of his prepared answering testimony?
>
> A. The changes discussed regarding the minimum bill in the tariff are equally relevant to the MDTQ in the service agreements. Article 3 of the service agreement makes the MDTQ provision expressly subject to the continuing jurisdiction of the Commission through

Transwestern's rate schedules and tariffs. Both the present minimum bill and MDTQ are forcing PLGS to purchase volumes of gas from Transwestern which Transwestern is not obligated to take-or-pay from its suppliers. Based on Transwestern's most recent PGA (TA83-2-42), approximately 79% of Transwestern's flowing supplies, or 707,072 Dth/d, are from supplies subject to take-or-pay obligations. The remainder of their present supplies consist of short term, best efforts gas. Transwestern has indicated that its system average contractual take-or-pay obligation to its firm suppliers is approximately 80% annually. Thus, Transwestern's contractual take-or-pay obligations to firm suppliers should be around 565 MDth/d. Premised on a total CDQ-based 75/25 allocation of these take-or-pay commitments between PLGS and Northwest, PLGS's share would be 425 MDthd. And yet the present MDTQ obligates PLGS to purchase a decatherm-adjusted 600 MMcfd and the annual minimum bill an average of 682.5 MMcfd, assuming tenders of full contract volumes. While Transwestern lacks storage facilities, it does have contractual flexibility in its purchase of firm supplies as well as its best efforts supplies. In addition, these firm supplies are declining at a rate of approximately 80 to 100 MMcfd per year. There is no valid reason to force PLGS and Northwest to take-or-pay for any supplies which Transwestern is not obligated to take-or-pay for under the present minimum bill or MDTQ.

Based upon the evidence of record, the arguments on brief and the discussion above, it is concluded that Transwestern's minimum bill provisions, in their entirety, are unjust, unreasonable, unduly discriminatory and preferential. We

now proceed to a discussion and analysis of the other proposals to determine which, if any, are just and reasonable and suitable for implementation on the Transwestern system.

**Other minimum bill proposals**

As discussed above, four proposals for lowering Transwestern's present minimum bills to levels varying from zero to 60 percent have been offered. Although each proposal has its origin in a different methodology or rationale, the claims made in support of each proposal by its proponents are similar and may be grouped together as follows: (1) the proposal alleviates the "anti-competitive" effects of Transwestern's present minimum bill; (2) the proposal sets the minimum bill at the lowest level which will assure Transwestern's continued viability while at the same time permitting its customers the maximum flexibility to make purchasing decisions on a "least cost" basis; (3) the proposal eliminates the discriminatory effects which the present minimum bill has on PLGS.

As to the first of these arguments, which is relied upon primarily by Staff and the Governor of California, it can hardly be contested that minimum bills set at any level have certain anticompetitive effects. The fundamental purpose of a minimum bill is to assure that customers purchase a certain quantity of gas from the pipeline in order, for instance, to permit recovery of the pipeline's fixed costs or to prevent it from incurring large take-or-pay exposure. *Atlantic Seaboard Corp.*, Opinion No. 523, 38 FPC 91 (1967). To accomplish their stated purpose therefore, minimum bills must, of necessity, somewhat limit the purchasing options of pipeline customers. However, to attempt to eradicate this

anticompetitiveness by modifying or eliminating Transwestern's minimum bills without due regard for potential consequential results, as some parties have done here, is symptomatic of the extreme stands that have swept this country in the past decade on antitrust and anticompetitiveness issues. We must concern ourselves with other anticompetitive effects that may occur if Transwestern's minimum bills are significantly reduced or eliminated, keeping in mind that governmental regulation has historically been directed toward the correction of specific abuses and not the destruction of free enterprise.

Primary amongst the reasonably anticipated results is a dramatic increase in the likelihood that the detrimental effects which Transwestern has predicted will occur if its minimum bills are eliminated or reduced, will in fact occur. As a result, the likelihood that Transwestern will be unable to remain a viable pipeline also increases. The loss of Transwestern as a supplier to the Southern California market would reduce competition and in the long run might well be more harmful to consumers in terms of anticompetitive effects than any level of minimum bill. Rather than address the potential impact on competition should Transwestern be removed from the scene, the proponents of lowering or reducing Transwestern's minimum bills have suggested that the evidence adduced clearly reflects that their respective proposals preserve the economic viability of Transwestern. We turn to that evidence.

When reduced to their essential elements, the arguments on both sides of this issue come down to a basic disagreement as to what quantities PLGS and Northwest Central will purchase from Transwestern. Transwestern contends that lowering or eliminating its minimum bills will jeopardize its continued existence by causing (1) larger "swings" on the

system than previously experienced, (2) an inability to compete successfully for gas purchases and (3) high take-or-pay exposure and an inability to raise sufficient capital to meet take-or-pay payments. The latter contention was explored extensively on the record. Transwestern predicted such draconian effects, based on its forecast that Northwest Central and PLGS will not purchase any gas above minimum bill levels. Specifically, Transwestern opined that if minimum bill levels were reduced to 35 percent, Northwest Central and PLGS would purchase only 35 percent of the contract quantity; if they were reduced to zero, Transwestern predicted zero sales. (I.B. at 76, 77) Using this assumption, Transwestern calculated that under the PLGS 35 percent proposal, it would incur over $1.5 billion in take-or-pay liability for the period from 1983 to 1988. (Exh. 126 at 4)

Other parties took a far more optimistic view of purchase levels and of Transwestern's potential take-or-pay liability. In the context of its own proposal, Northwest Central stated that it was willing to purchase at a 50 percent minimum bill level. (Exh. 69 at 5; I.B. at 23) It was somewhat less clear that it would purchase at this level under a lower minimum bill level. (Exh. 32 at 4-6). PLGS forecasted that under average conditions it would purchase 530 MMcfd. (Exh. 171). Utilizing these purchase quantities PLGS predicted that, assuming no additions in supply, Transwestern would not incur any take-or-pay liability. (Exh. 170; I.B. at 48). El Paso similarly predicted that Transwestern would incur no take-or-pay exposure under its 60 percent proposal. (Exh. 153)

A fundamental problem with the somewhat rosy predictions of PLGS and El Paso is that they assumed operation of minimum bills which included both variable and fixed costs. As mentioned above, under Order No. 380, Transwestern may no longer collect variable costs in its minimum bills.

Because Order No. 380 was issued after the record was closed in this proceeding, the degree to which the elimination of variable costs will affect the buying patterns of Transwestern's customers has not been explored. That such patterns will be affected, however, is clear; variable costs account for approximately 90 percent of Transwestern's CDQ commodity charge. (Staff I.B., Appendix A at 2) It therefore is apparent that customer purchase prognostications based upon minimum bills which include variable costs presented on this record by all parties, including Transwestern, are no longer meaningful and cannot be relied upon. Common sense dictates that when 90 percent of the costs are deleted from a minimum bill charge, customers will have far less incentive to purchase at minimum bill levels. Such a disincentive would appear to be even greater where, as with PLGS, the customer has affiliated suppliers.

The final generic claim of proponents of a lower level of minimum bill is that the proposals will eliminate the discriminatory effects of the present minimum bills. As held, earlier, the present differences in the minimum bills applicable to PLGS and Northwest Central have been found to be unduly discriminatory and preferential. Consequently, any minimum bill level adopted herein will of necessity be applicable to both customers.

In summary, it is concluded that the claims of the proponents for each of the four proposals that their respective offering preserves the economic liability of Transwestern while keeping its minimum bills at the lowest possible level are lacking in substantial evidentiary support. Additionally, under the given factual circumstances, *i.e.,* two pipelines serving the limited market of one of the pipelines, it would be patently unfair and indeed have anticompetitive overtones if Transwestern's minimum bill was set at a level below that of El Paso. Did not the Commission say so in so

many words when it authorized the creation of Transwestern and set Transwestern's minimum bill at the existing level of El Paso's minimum bill? And would it not perpetuate the very situation that is so sorely decried except for the fact that the shoe would be on the other foot and El Paso would have the advantage?

The only practical and evidentiary supportable approach that (1) diminishes the anticompetitiveness of Transwestern's current minimum bill, (2) eliminates any governmentally created unfair competition between El Paso and Transwestern, (3) has the past imprimatur of the Commission and (4) eliminates the need for concern over whether Transwestern will remain a viable pipeline supplier is one that places Transwestern and El Paso on a parity in competing for the Southern California market.

Unlike the previous arguments disposed of above, El Paso's parity proposal is unique in that it alone can claim to be in keeping with the Commission's original rationale for approving the current level of Transwestern's minimum bills. Recall that in initially approving the 91% minimum bill appliable to PLGS the Commission stated (22 FPC 543):

> Inasmuch as El Paso has a 91 percent minimum bill for gas which it sells to these same distribution companies, and it appears that a similar provision would protect Transwestern from discrimination in the event of market fluctuations and insure the financing of its project, we shall modify Opinion No. 328 and the accompanying order by requiring a reduction in the proposed minimum bill from 100 percent to 91 percent, instead of to 75 percent.

As did the 91 percent minimum bill at the time it was approved, El Paso's 60 percent proposal similarly places Transwestern and El Paso on equal footing and permits the two Southern California suppliers to compete freely. While the Commission does not guarantee the continued

profitability of a pipeline subject to its jurisdiction, it should not, on the other hand, place it in economic jeopardy by allowing an unfair advantage to its competitor. In this regard the Presiding Judge takes notice of, and incorporates into this evidentiary record as items by reference to the Commission's files, El Paso's PGA filing of August 31, 1984, in Docket No. TA85-1-33-000 (PGA85-1 and IPR 85-1) and Transwestern's PGA filing of the same date in Docket No. TA85-1-42-000 (PGA85-1 and IPR 85-1). A review of those two filings discloses that the system average cost of gas of El Paso and Transwestern are now almost at parity and competitive with each other. Placing them on the same minimum bill level will enhance the competition between the two pipelines for the market above the 60 percent level to the ultimate benefit of the Southern California consumers.

From the above discussion it is apparent that only the El Paso Proposal is in keeping with previous Commission dictates concerning the Southern California market and that it alone will assure equal treatment of the two major suppliers to that market. How, however does this proposal impact upon Northwest Central which occupies a completely different market? As discussed above, Transwestern's service to Northwest Central is, for all intents and purposes identical to its service to PLGS, and as a consequence its rates should be structured similarly to those of PLGS to avoid undue discrimination. Moreover, there is a proximity between the minimum bill level suggested by El Paso and that endorsed by Northwest Central. Northwest Central favors a minimum bill set at a 50 percent level, however, its proposal assumed operation of a minimum bill which included variable costs. The burden to Northwest Central of a 60 percent minimum bill which collects no variable costs could hardly be considered to be greater than a 50 percent

minimum bill which collects both fixed and variable costs, and thus should not be objectionable to it.

Finally, as to the various proposals to change Transwestern's currently effective rate design, such proposals are not supported by substantial evidence and must be rejected. Moreover, the proponents for a change in rate design have not argued, let alone submitted evidence, that the present Transwestern rate design is unjust, unreasonable, unduly discriminatory or preferential. Both the Staff's and PLGS' proposals were offered "in conjunction" with their specific minimum bill proposals in order to ameliorate the effects of adopting their minimum bill levels. (Exh. 45 at 3-10, Exh. 85 at 21) As neither of these minimum bill levels have been adopted there is no need to give them further consideration.

As to the El Paso "modified cost behavior" proposal, El Paso's witness Mr. Jack stated that "rate design is an integral part of my proposal." (Exh. 55 at 24) However, he provided little or no evidence supporting the need for such a proposal aside from stating that El Paso adopted a similar rate design in a recent settlement agreement. (*Id.*) Although the Commission has in the past, indicated a desire to put El Paso and Transwestern on equal footing as regards to minimum bill levels, it has not revealed a similar desire to do so in regards to rate design.

In adopting the minimum bill level contained in El Paso's parity proposal, the Presiding Judge specifically rejects the part of that proposal which would require pro rata takes by PLGS from both suppliers if its purchases fell below the 60 percent minimum bill level. The only pipeline tariff before us in this proceeding is that of Transwestern. The settlement instituting a 60 percent minimum bill in El Paso's tariff, now pending rehearing before the Commission, does not contain such a provision. Inclusion of such a condition here would have no legally binding effect on El Paso.

## Conclusion

Based upon the evidentiary record, the arguments on brief and the analysis above, it is concluded that an annual minimum bill of 60 percent on the Transwestern system applicable to PLGS and to Northwest Central is just and reasonable and is adopted for prospective implementation, provided, that, El Paso has, or simultaneously places in effect, a similar minimum bill at the same 60 percent level. All other proposals have insufficient evidentiary support to sustain a finding of just and reasonableness.

## Order

Wherefore, *it is ordered* that subject to review by the Commission on exceptions or on its own motion, that:

> Within twenty (20) days from the issuance of this decision, Transwestern Pipeline Company will file revised tariff sheets eliminating its current minimum bill provisions including the Minimum Daily Take Quantity provision applicable to PLGS only, and substitute instead a 60 percent annual minimum bill provision applicable to Pacific Lighting Gas Supply Company and Northwest Central Pipeline Corporation, provided that El Paso Natural Gas Company has, or simultaneously places in effect, a similar minimum bill at the same 60 percent level.

[¶ 63,055]

**Kansas City Power & Light Company,**
**Docket No. ER82-123-000**
**Certification of Uncontested Settlement**
**(Issued December 10, 1984)**
**Max L. Kane, Administrative Law Judge.**

On October 31, 1984 Kansas City Power & Light Company filed an Offer of Settlement in this proceeding resolving the only remaining outstanding issues.

The Presiding Judge in an order granting Staff's unopposed motion for an extension of filing for initial and reply comments, set those dates as December 4, and December 14, respectively. The only comments received were submitted by Staff recommending acceptance and approval of the proposed settlement. Consequently, there is no need to await the expiration of the 10 days to reply comments.

There is herewith certified to the Commission for appropriate action the Offer of Settlement, a proposed Order Accepting Offer of Settlement, and the Staff comments recommending that the Settlement be certified to the Commission for approval.

# APPENDIX F

## NATURAL GAS ACT

**§ 4(d), 15 U.S.C. §§ 717c(e) (1982).**

Whenever any such new schedule is filed the Commission shall have authority, either upon complaint of any State, municipality, State commission, or gas distributing company, or upon its own initiative without complaint, at once, and if it so orders, without answer or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of the suspension period, on motion of the natural-gas company making the filing, the proposed change of rate, charge, classification, or service shall go into effect. Where increased rates or charges are thus made effective, the Commission may, by order, require the natural-gas company to furnish a bond, to be approved by the Commission, to refund any amounts ordered by the Commission, to keep accurate accounts in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf

such amounts were paid, and, upon completion of the hearing and decision, to order such natural-gas company to refund, with interest, the portion of such increased rates or charges by its decision found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

**§ 5(a), 15 U.S.C. § 717d(a)(1982).**

Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided, however,* That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.

**§ 7(e), 15 U.S.C. § 717f(e)(1982).**

Except in the cases governed by the provisos contained in sub-section (c)(1) of this section, a certificate shall be issued to any qualified applicant therefor, authorizing the whole or any part of the operation, sale, service, construction, extension, or acquisition covered by the application, if it is found that the applicant is able and willing properly to do the acts and to perform the service proposed and to conform to the provisions of this chapter and the requirements, rules, and regulations of the Commission thereunder, and that the proposed service, sale, operation, construction, extension, or acquisition, to the extent authorized by the certificate, is or will be required by the present or future public convenience and necessity; otherwise such application shall be denied. The Commission shall have the power to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as the public convenience and necessity may require.

**§ 19(b), 15 U.S.C. § 717r(b)(1982).**

Any party to a proceeding under this Act aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the [circuit] court of appeals of the United States for any circuit wherein the natural-gas company to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be transmitted by the clerk of the court to any member of the Commission and thereupon the Commission shall file with the court the record upon which the order complained of was entered, as provided in section 2112 of Title 28. Upon

the filing of such petition such court shall have jurisdiction, which upon the filing of the record with it shall be exclusive, to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 239 and 240 of the Judicial Code, as amended.

# APPENDIX G

## ADMINISTRATIVE PROCEDURE ACT

**§ 5, 5 U.S.C. § 554 (1982).**

(a) This section applies, according to the provisions thereof, in every case of adjudication required by statute to be determined on the record after opportunity for an agency hearing, except to the extent that there is involved —

(1) a matter subject to a subsequent trial of the law and the facts de novo in a court;

(2) the selection or tenure of an employee, except a administrative law judge appointed under section 3105 of this title;

(3) proceedings in which decisions rest solely on inspections, tests, or elections;

(4) the conduct of military or foreign affairs functions;

(5) cases in which an agency is acting as an agent for a court; or

(6) the certification of worker representatives.

(b) Persons entitled to notice of an agency hearing shall be timely informed of —

(1) the time, place and nature of the hearing;

(2) the legal authority and jurisdiction under which the hearing it to be held; and

(3) the matters of fact and law asserted.

When private persons are the moving parties, other parties to the proceeding shall give prompt notice of issues controverted in fact or law; and in other instances agencies may by rule require responsive pleading. In fixing the time and place for hearings, due regard shall be had for the convenience and necessity of the parties or their representatives.

(c) The agency shall give all interested parties opportunity for —

(1) the submission and consideration of facts, arguments, offers of settlement, or proposals of adjustments when time, the nature of the proceeding, and the public interest permit; and

(2) to the extent that the parties are unable so to determine a controversy by consent, hearing and decision on notice and in accordance with sections 556 and 557 of this title.

(d) The employee who presides at the reception of evidence pursuant to section 556 of this title shall make the recommended decision or initial decision required by section 557 of this title, unless he becomes unavailable to the agency. Except to the extent required for the disposition of ex parte matters as authorized by law, such an employee may not —

(1) consult a person or party on a fact of issue, unless on notice and opportunity for all parties to participate; or

(2) be responsible to or subject to the supervision or direction of an employee or agent engaged in the performance of investigative or prosecuting functions for an agency.

An employee or agent engaged in the performance of investigative or prosecuting functions for an agency in a case may not, in that or a factually related case, participate or advise in the decision, recommended decision, or agency review pursuant to section 557 of this title, except as witness or counsel in public proceedings. This subsection does not apply —

(A) in determining applications for initial licenses;

(B) to proceedings involving the validity or application of rates, facilities, or practices of public utilities or carriers; or

(C) to the agency or a member or members of the body comprising the agency.

(e) The agency, with like effect as in the case of other orders, and in its sound discretion, may issue a declaratory order to terminate a controversy or remove uncertainty.

**§ 7, 5 U.S.C. § 556 (1982).**

(a) This section applies, according the provisions thereof, to hearings required by section 553 or 554 of this title to be conducted in accordance with this section.

(b) There shall preside at the taking of evidence —

(1) the agency;

(2) one or more members of the body which comprises the agency; or

(3) one or more hearing examiners appointed under section 3105 of this title.

This subchapter does not supersede the conduct of specified classes of proceedings, in whole or in part, by or before boards or other employees specially provided for by or designated under statute. The functions of presiding employees and of employees participating in decisions in accordance with section 557 of this title shall be conducted in an impartial manner. A presiding or participating employee may at any time disqualify himself. On the filing in good faith of a timely and sufficient affidavit of personal bias or other disqualification of a presiding or participating employee, the agency shall determine the matter as a part of the record and decision in the case.

(c) Subject to published rules of the agency and within its powers, employees presiding at hearings may —

(1) administer oaths and affirmations;

(2) issue subpenas authorized by law;

(3) rule on offers of proof and receive relevant evidence;

(4) take depositions or have depositions taken when the ends of justice would be served;

(5) regulate the course of the hearing;

(6) hold conferences for the settlement or simplification of the issues by consent of the parties;

(7) dispose of procedural requests or similar matters;

(8) make or recommend decisions in accordance with section 557 of this title; and

(9) take other action authorized by agency rule consistent with this subchapter.

(d) Except as otherwise provided by statute, the proponent of a rule or order has the burden of proof. Any oral or documentary evidence may be received, but the agency as a matter of policy shall provide for the exclusion of irrelevant, immaterial, or unduly repetitious evidence. A sanction may not be imposed or rule or order issued except on consideration of the whole record or those parts thereof cited by a party and supported by and in accordance with the reliable, probative, and substantial evidence. The agency may, to the extent consistent with the interests of justice and the policy of the underlying statutes administered by the agency, consider a violation of section 557(d) of this title sufficient grounds for a decision adverse to a party who has knowingly committed such violation or knowingly caused such violation to occur. A party is entitled to present his case or defense by oral or documentary evidence, to submit rebuttal

evidence, and to conduct such cross-examination as may be required for a full and true disclosure of the facts. In rule making or determining claims for money or benefits or application for initial licenses an agency may, when a party will not be prejudiced thereby, adopt procedures for the submission of all or part of the evidence in written form.

(e) The transcript of testimony and exhibits, together with all papers and requests filed in accordance with section 557 of this title and, on payment of lawfully prescribed costs, shall be made available to the parties. When an agency decision rests on official notice of a material fact not appearing in the evidence in the record, a party is entitled, on timely request, to an opportunity to show the contrary.